SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 537

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

INTER-MOUNTAIN LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

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A [Caption omitted.]

1 Before United States Board of Tax Appeals

Docket No. 20997

INTER-MOUNTAIN LIFE INSURANCE CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For petitioner: Abram R. Serven, Esq., Guy Patten, Esq. For respondent: Jas. C. Maddox, Esq.

Docket entries

1926
Nov. 1—Petition received and filed. Taxpayer notified.
Nov. 2—Copy of petition served on general counsel.
Dec. 31—Answer filed by general counsel.

1927
Jan. 27—Copy of answer served on taxpayer—assigned General Calendar.

1928
Sept. 26—Hearing set Nov. 13, 1928.
Oct. 17—Motion for transfer to San Francisco, Calif., circuit calendar filed by taxpayer.
Oct. 17—Notice of appearance of Abram R. Serven as counsel for taxpayer filed.
Oct. 18—Motion granted.

1929
Feb. 11—Motion for leave to file amended petition filed by taxpayer, amendment tendered.
Feb. 13—Motion granted.
Feb. 15—Copy of motion and amended petition served on general counsel.
April 16—Answer to amended petition filed by general counsel. 4/17/39 copy served.
April 25—Motion to place on the Reserve Calendar filed by taxpayer. 4/26/29 granted.

2 1932
July 29—Hearing set Nov. 16, 1932.
Nov. 16—Hearing had before Mr. Sternhagen on merits. Submitted. Amendment to answer received—served. Judgment for petitioner under Rule 50. Stipulation of facts filed.
Nov. 26—Transcript of hearing Nov. 16, 1932 filed.

1933
March 28—Notice of settlement filed by general counsel.
March 31—Hearing set April 26, 1933, on settlement.
April 3—Consent to settlement filed by taxpayer.
April 8—Judgment entered—John M. Sternhagen, Division 10.

1933
July 3—Petition for review by U. S. Circuit Court of Appeals, 10th Circuit, with assignments of error filed by general counsel.
July 5—Proof of service filed by general counsel.
July 13—Proof of service of petition filed by general counsel (taxpayer).
July 21—Stipulation to correct assignments of error filed.
July 31—Motion for extension to Oct. 12, 1933, to complete and transmit record filed by general counsel.
July 31—Order enlarging time to Oct. 12, 1933, for preparation of evidence and delivery of record entered.
Oct 12—Motion for extension to 12/11/33 to complete record filed by general counsel.
Oct. 12—Order enlarging time to Dec. 11, 1933, for preparation of evidence and delivery of record entered.
Nov. 11—Praecipe with proof of service thereon filed by general counsel.

3 Before U. S. Board of Tax Appeals

Amended petition.

Filed Feb. 13, 1929

The above-named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue, set forth in his deficiency letter (IT:CA-2552-10-60D), dated October 14, 1926, and as the basis of its appeal sets forth the following:

1. The petitioner is a corporation organized under the laws of the State of Utah, with its principal office at Sacramento, California. Since the original petition was filed all outstanding business, assets, and liabilities of the petitioner have been taken over by the California State Life Insurance Company, of Sacramento, Calif., and its records moved from Salt Lake City, Utah (the principal office prior to sale), to Sacramento, Calif.

2. The deficiency letter (copy of which is attached and marked "Exhibit A") was mailed to the petitioner on October 14, 1926, and states a deficiency of $1,903.50 for the year 1922.

3. The taxes in controversy are income taxes for the calendar year 1922 and are less than $10,000, to wit: $1,903.50; of this sum only $877.73 is contested in the original petition. As the decision of the honorable Board of Tax Appeals in the appeal of Standard Life

Insurance Company of America vs. Commissioner of Internal Revenue (Docket Nos. 12475, 25842, and 29779), promulgated July 23, 1928, is acquiesced in by the respondent, only $193.32 is in controversy.

4. The determination of taxes contained in said deficiency letter is based upon the following errors:

(a) The elimination from the reserves in schedule C of the income-tax return of the amount of coupons and dividends held on deposit, viz:

Dividends and coupons and interest on deposit December 31, 1921	$127,298.16
Dividends and coupons and interest on deposit December 31, 1922	146,477.35
Total	273,770.51
Mean	136,885.25
4% of above	5,475.41

4 (b) The elimination from the deductions of schedule A of the income-tax return of $202.61 which was charged off as depreciation on furniture and fixtures.

(c) The Commissioner failed to allow as a deduction from gross income for the year 1922 depreciation on automobiles purchased by petitioner in the year 1921 for use in its business.

(d) The Commissioner did not allow as a deduction from gross income for the year 1922 the full 4% of the mean of the reserve funds required by law in addition to the reserves for coupons and dividends held on deposit to be held at the beginning and end of the taxable year 1922 amounting to $43,170.99 for said year.

(5) The petitioner respectfully alleges the following facts in connection with these errors:

(a) Under the provisions of section 245 (a) (2) of the 1921 Revenue Act, the petitioner is legally entitled to include in the four (4) per centum of the mean of the reserve funds required by law to be held at the beginning and end of the taxable year 1922 the reserve for the payment of the unsurrendered policy coupons and interest thereon which it was required to maintain at the beginning and end of the taxable year by the insurance department of the State of Utah and the insurance laws of the various States in which it transacts business. This honorable Board has held in its decision in the appeal of Standard Life Insurance Company of America vs. Commissioner of Internal Revenue (Docket Nos. 12475, 25842, and 29779), promulgated July 23, 1928, that such amounts so held by life insurance companies to meet the payment of unsurrendered policy coupons and interest thereon is a part of the reserve funds required by law in computing the legal deduction from gross income under section 245 (a) (2) of the 1921 Revenue Act, and the respondent has, by the order of redetermination entered October 16, 1928, accepted said reserve as part of the reserves required by law.

(b) On December 31, 1922, the petitioner had $2,968.29 invested in office furniture and fixtures which had been purchased since January 1, 1921. This investment of $2,968.29 included purchases
5 of $1,884.24 during the year 1922 and the balance of $1,084.05

in the year 1921. Under the provisions of section 245 (a) (7) of the 1921 Revenue Act, the petitioner is entitled to deduct depreciation of $202.61 on its furniture and fixtures for the year 1922.

(c) On December 31, 1922, the petitioner had $3,980 invested in automobiles purchased for use in its business during the year 1921, and under the provisions of section 245 (a) (7) of the 1921 Revenue Act, the petitioner is entitled to deduct depreciation of $995 on said machines for the year 1922.

(d) Under the decision of the Supreme Court of the United States, of June 4, 1928, in the case of National Life Insurance Company v. United States, 48 Sup. Ct. 591, the petitioner is entitled to deduct from gross income the sum of $43,170.99 instead of $37,710.06, the full 4% of the mean of the reserve funds required by law to be held at the beginning and end of the taxable year 1922, without diminishing said 4% by $9,742.93, interest received from tax-exempt securities during said year under the provisions of section 245 (a) (2) of the 1921 Revenue Act (Treasury Decision No. 4231).

Wherefore, the premises considered, your petitioner respectfully prays:

(1) That its appeal from the deficiency in taxes hereinbefore stated may be allowed and said deficiency in tax set aside and nullified;

(2) That its tax liability for the year 1922 may be correctly computed and the correct deficiency or overpayment, if any, may be determined by this honorable Board, and

(3) For such other and further relief as to this honorable Board may seem just and proper.

ABRAM R. SERVEN,
Of Counsel for Petitioner,
1422 F St. NW., Washington, D. C.

[*Duly sworn to by Joshua Greenwood jurat omitted in printing.*]

6 *Exhibit A to amended petition*

Form NP-2

TREASURY DEPARTMENT,
Washington, Oct. 14, 1926.

Office of Commissioner of Internal Revenue. IT:CA-2552-10-60D.

INTER-MOUNTAIN LIFE INSURANCE COMPANY,
1120 Boston Building, Salt Lake City, Utah.

SIRS: The determination of your income tax liability for 1922, as set forth in office letter of September 2, 1926, discloses a deficiency in tax of $1,903.50, as shown in the attached statement.

In accordance with the provisions of section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of

this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made,
7 the unpaid amount of the assessment must be paid upon notice and demand from the collector of internal revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT: CA-2552-10-60D. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. Blair,
Commissioner.
By C. R. Nash,
Assistant to the Commissioner.

Inclosures: Statement form A, form 882.

Statement

IT: CA-2552-10-60D.

In re: Inter-Mountain Life Insurance Company, 1120 Boston Building, Salt Lake City, Utah.

Year 1922:

Deficiency in tax	$1,903.50
Income reported in amended return	28,365.74
Add:	
1. Change of 4% of mean of reserve over exempt interest	13,681.63
2. Depreciation	1,546.41
Adjusted income	43,593.78

Explanation of adjustments

1. The coupons left with the company to accumulate with interest have been eliminated in computing the 4% of mean of reserves in

accordance with the Solicitor's ruling 9610, published in bulletin dated August 23, 1926.

Capital stock and other items included in line 7 of the return have been eliminated as they are not reserves in accordance with article 681 of Regulations 62.

8 Reserves, page 2:

	I. Beginning of year	II. End of year
Line 7	$844,822.86	$993,454.98
Line 8	11,655.01	12,633.75
Line 9	9,570.79	13,365.41
Total	866,048.66	1,019,454.14
Total, columns I and II		1,885,502.80
Mean of reserve funds (½ of item 9)		942,751.40
4% of mean of reserve funds corrected		37,710.06
Per return of taxable year		51,391.69
Difference		13,681.63

The correct computation is shown below:

Computation of tax

Gross income	$85,650.45
Deductions	42,056.67
Net income	45,593.78

Inter-Mountain Life Insurance Company

Statement

Balance	$43,593.78
Income tax assessable, 12½% of net income	5,449.22
$2,070.36 plus $1,475.36—tax assessed	3,545.72
Additional tax	1,903.50

2. As life-insurance companies are allowed depreciation on only those items used in connection with the handling of the company's investments, and as your schedules do not indicate this to be the case, the depreciation is disallowed as a deduction from income. Again, life-insurance companies are taxed only on interest, rents, and dividends and, therefore, depreciation is allowed only on those assets used in producing this income.

Net income adjusted subject to tax		$43,593.78
Tax at 12½%		5,449.22
Original tax	$2,070.36	
Tax on amended return	1,475.36	
		3,545.72
Difference		1,903.50

9 Payment should not be made until a bill is received from the collector of internal revenue for your district and remittance should then be made to him.

This office is unable to concede to your contentions set forth in protest dated September 21, 1926.

Before U. S. Board of Tax Appeals

Answer to amended petition

Filed April 16, 1929

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, for answer to the amended petition of this taxpayer, admits and denies as follows:

1. Admits that petitioner is a corporation organized under the laws of the State of Utah. For lack of information sufficient to form a belief as to the truth or falsity thereof, denies the remaining allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits that the taxes in controversy are income taxes for the calendar year 1922 and are less than $10,000.00. Denies the remaining allegations of paragraph 3.

4. (a–d). Denies each and every assignment of error pleaded in paragraph 4, subparagraphs (a) to (d), inclusive.

5. (a–d). Denies each and every allegation of fact properly pleaded in paragraph 5, subparagraphs (a) to (d), inclusive.

Denies individually and collectively each and every allegation of fact properly pleaded in the taxpayer's amended petition not hereinbefore specifically admitted, qualified, or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of counsel: A. H. Willey, special attorney, Bureau of Internal Revenue. 4–16–29.

10 *Amendment to answer to amended petition*

Filed at hearing, Nov. 16, 1932

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, amends his answer to the amended petition of this taxpayer by adding to paragraph 5 ((a) to (d)) the following:

Avers that in determining the net income upon which the deficiency shown in notice of deficiency dated October 14, 1926 is based, he allowed as a deduction for the calendar year 1922 the amount of $897.58, interest paid to holders of coupon policies on amounts theretofore left by such policyholders to accumulate at interest upon surrender during the year 1922 of matured coupons; that in the event it is held that the liability of petitioner for amounts left with it to accumulate at interest represented by unpaid matured coupons attached to coupon policies and the compound interest thereon is a reserve fund required by law, then such interest in the amount of $897.58 was improperly allowed as a deduction from gross income for the calendar year 1922.

And amends the prayer to read as follows:

Wherefore, it is prayed that the taxpayer's appeal be denied and that the deficiency shown in notice of deficiency dated October 14, 1926, be increased on account of the disallowance of the deduction of interest in the amount of $897.58 paid to policyholders on amounts represented by coupons surrendered during the calendar year 1922 and claim is hereby made for such increased amount of deficiency.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of counsel: DeWitt M. Evans, special attorney, Bureau of Internal Revenue.

11d 11/15/32.

Before U. S. Board of Tax Appeals

Stipulation of facts

Filed at hearing, Nov. 16, 1932

It is hereby stipulated and agreed, by and between Inter-
11 Mountain Life Insurance Company, petitioner herein, and the Commissioner of Internal Revenue, respondent herein, that the following are facts which may be considered by the Board in this appeal:

1. Petitioner is a capital-stock life insurance company organized under the laws of the State of Utah in the year 1911. During the calendar year 1922 its principal office was located at Salt Lake City, Utah. It filed its Federal income-tax return for the calendar year 1922 in the office of the Collector of Internal Revenue for the District of Utah in Salt Lake City, Utah. Its books of account and its Federal income-tax return for the calendar year 1922 were upon a cash receipts and disbursements basis.

2. During the calendar year 1922 and for a long time prior thereto petitioner was engaged in the business of issuing life insurance contracts in Utah, Idaho, and Arizona. Among the insurance contracts so issued were those denominated 20-payment life coupon policy—nonparticipating. A specimen of this type of policy is hereto attached marked "Exhibit A" and is made a part of this stipulation.

3. Each of the policies of which exhibit A of this stipulates is a specimen, is issued with nineteen coupons attached thereto. Such coupons mature serially on anniversary dates of the policy beginning with the first anniversary and ending with the nineteenth, provided the premiums for the policy year beginning on the date of the coupon are paid and all premiums previously due have been paid. Each coupon is a promise that at its maturity petitioner will pay to the owner of the policy the amount thereof. By the terms of the policy the insured is given certain elections and options respecting such coupons among which it is provided that the petitioner will credit to the insured the face amount of any matured coupon, as

said coupon, becomes due, and will pay compound interest thereon at the rate of three and one-half per centum per annum, thereby creating a fund to the credit of the insured, which amount may be applied to the payment of premiums or withdrawn in cash at any time by the insured and if not so applied or withdrawn by the insured prior to his death, the values represented by the coupons, with interest to date of death, will, in the event of the death of the insured while the policy is in force, be paid to the beneficiary, in addition to the face amount of the policy, upon surrender
12 to the petitioner of the policy and all coupons issued therewith and unpaid or unmatured prior to the date of said death.

4. On January 1, 1922, petitioner's liability for amounts which had been left with it to accumulate at interest represented by unpaid matured coupons attached to policies then in force of the type of which exhibit A of this stipulation is a specimen, and the compound interest thereon from the maturity date of each coupon, was $126,949.03. On December 31, 1922, the amount of such liability was $146,097.75. The mean amount of these sums is $136,523.39, and this amount of $136,523.39 has not been included in the amount of reserve funds required by law, 4% of which was allowed as a deduction in notice of deficiency dated October 14, 1926, from which this appeal is taken.

5. Pursuant to the terms of the policies of which exhibit A of this stipulation is a specimen, the insured, at any time during the first policy year or within one month after the due date of the second annual premium, may, in writing, elect to convert the coupons originally attached to such policies, as such coupons mature, into paid-up life additions to the policy for amounts shown on the reverse side of each coupon and each coupon must be surrendered to the company within one month of its due date, and payment of the annual premium due on same date made in full in cash. The reverse side of the coupons reads:

"Paid-up addition for this coupon

----------dollars

Payable at death in addition to the principal sum insured, but reconvertible at any time into its cash value."

When the coupon is so surrendered for paid-up additions to the policy and full premiums paid, petitioner issues to insured a letter of acknowledgment of his remittance and coupon in which it is stated that the amount of the paid-up life insurance has been effected. The paid-up addition to the policy is then only reconvertible into its cash surrender value.

6. In computing the net income shown in notice of deficiency dated October 14, 1926, from which this appeal is taken, the
13 deduction for 4% of the mean of reserve funds required by law was allowed therein an amount reduced by $9,742.93, representing interest received during the calendar year 1922 on tax-exempt securities which was included in gross income; that the net

income as shown in such notice of deficiency should be reduced by the amount of $9,742.93.

7. Petitioner abandons its contention that it be allowed depreciation on furniture and fixtures owned on December 31, 1922, in the amount of $202.61, which is set forth in assignment of error 4 (b) and allegation of fact paragraph 5 (b) of the amended petition filed herein.

8. During the calendar year 1922, petitioner paid to holders of policies, of the type of which exhibit A is a specimen, interest on amounts theretofore left to accumulate at interest represented by matured coupons surrendered during that year together with the amounts represented by such coupons as were surrendered during that year; the amount of such interest was $897.58 and that amount of interest has been allowed as a deduction in determining the net income upon which the deficiency shown in notice of deficiency dated October 14, 1926, is based. It is agreed that in the event the Board holds that the liability of petitioner for amounts left with it to accumulate at interest represented by unpaid matured coupons attached to policies of the type of which exhibit A is a specimen and the compound interest thereon is a reserve fund required by law, then such amount of interest of $897.58, paid to policyholders on amounts represented by coupons surrendered shall not be deducted from gross income for the calendar year 1922, and the net income for that year as shown in notice of deficiency dated October 14, 1926, shall be increased accordingly.

9. The reserves to the nearest dollar as at the end of the policy years indicated for each $1,000.00 of insurance on 20-payment life coupon policy—nonparticipating, of which exhibit A is a specimen, under the hypotheses stated below, are as follows:

[34]

End of policy year	Reserve—exclusive of the cash value of any matured outstanding coupons	Reserve—if the paid-up addition option is in force as provided on page 3 of the policies of which exhibit A is a specimen	End of policy year	Reserve—exclusive of the cash value of any matured outstanding coupons	Reserve—if the paid-up addition option is in force as provided on page 3 of the policies of which exhibit A is a specimen
1	None	None	11	$249.00	$357.00
2	$21.00	$29.00	12	279.00	400.00
3	43.00	60.00	13	311.00	448.00
4	65.00	91.00	14	343.00	496.00
5	89.00	126.00	15	377.00	545.00
6	113.00	159.00	16	412.00	600.00
7	138.00	195.00	17	449.00	653.00
8	165.00	234.00	18	486.00	711.00
9	192.00	271.00	19	525.00	770.00
10	220.00	312.00	20	566.00	833.00

(Signed) GUY PATTEN,
Counsel for Petitioner.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

11d 11/15/32.

RGW

Exhibit A to stipulation of facts, page 1

Incorporated as a stock company by the State of Utah

Amount $10,000.00. Number Sample.

Inter-Mountain Life Insurance Company

Salt Lake City, Utah

Age 35. Premium $420.90.

Will pay ten thousand dollars ($10,000.00) (the face of this policy) to Mary Doe, wife of the insured, beneficiary, or to such other beneficiary as may be designated by the insured as hereinafter provided, at the home office of the company, immediately after receipt of due proof of the death of: John Doe, the insured, while this policy is in force.

Guaranteed options at the end of twenty years

If all the premiums due hereon as stated in the consideration paragraph herein are paid to the company in full in cash, and if as each coupon attached hereto matures, the amount thereof has been left with the company to accumulate at interest, then upon the surrender of this policy and all coupons which are attached hereto at date of issue, the insured shall select one of the following options at the end of twenty years from the date hereof:

1. A guaranteed cash payment of eight thousand dollars.
2. A paid-up policy for life of fourteen thousand one hundred thirty dollars, subject to satisfactory evidence of insurability for the excess over the orginal face amount of this policy.
3. A guaranteed annual income of four hundred ninety dollars, to continue for at least twenty years and as many years thereafter as the insured shall survive.
4. A paid-up policy for life of ten thousand dollars, without medical reexamination, and an annual income of $174.40 dollars, payable annually thereafter during the life of the insured.

Consideration: The consideration for this policy is the application herefor, which is hereby made a part of this contract, a copy of which application is attached hereto or endorsed hereon, and of the cash payment in advance of an annual premium of four hundred twenty and 90/100 dollars ($420.90) for term insurance for one year ending on the first day of December 1920, and the payment of an equal sum on or before the first day of December in every year hereafter, until full premiums have been paid for twenty years from the date hereof or until the prior death of the insured.

The benefits, privileges, conditions, and tables stated on the following pages hereof are a part of this policy as fully as if recited and shown in full over the signatures hereto affixed.

16 In witness whereof, the Inter-Mountain Life Insurance Company has caused this policy to be executed at Salt Lake City, Utah, this first day of December 1919.

Attest:

Sample.
Secretary.

President.

The reserve under this policy shall be invested in first mortgages on real estate, in United States, State, county, or municipal bonds, or other securities in conformity with the insurance code of the State of Utah.

(Seal.)

20-Payment Life Coupon Policy----------Non-Participating.

Form 2. Ed. 10-29-19. 2000

Exhibit A, page 2

Benefits, privileges, conditions, and tables referred to on page one hereof

Additional death benefit: If any or all of the values represented by the coupons attached hereto at date of issue are left on deposit with the company at three and one-half per centum compound interest per annum, such values of said coupons, with interest to date of death, will, in the event of the death of the insured while this policy is in force, be paid to the beneficiary, in addition to the face amount hereof, upon surrender to the company of this policy and all coupons issued therewith and unpaid or unmatured prior to the date of said death.

Fully paid-up benefit: If all of the values represented by the first fourteen coupons attached to this policy at issue, are left on deposit with the company at compound interest as aforesaid, the company will, upon written request of the insured hereunder, issue in lieu of this policy a fully paid-up policy for ten thousand dollars ($10,000) at the end of fifteen years from the date of this policy, upon the surrender to the company of this policy and all of the coupons originally attached hereto.

Savings fund: If any premium after the first, as provided in the consideration paragraph herein, is paid to the company in full in cash, the company will credit to the insured hereunder the
17 face amount of any coupon then matured, as said coupon becomes due, and will pay compound interest thereon at the rate of three and one-half per centum per annum, thereby creating a fund to the credit of this policy, which fund may be applied to the payment of premiums or withdrawn in cash at any time by the insured.

Cash loans: After three full years' premiums have been paid hereon, the company, at any time while this policy is in force, will

loan, upon the proper assignment of this policy and upon the sole security thereof, at a rate of interest which will not exceed six per centum per annum, a sum equal to, or at the option of the owner hereof, less than the loan value hereon at the end of the then current policy year. The company will deduct from such loan value any existing indebtedness hereon, and any unpaid balance of the premium for the current policy year, and will collect interest in advance on the loan to the end of the current policy year and annually in advance thereafter. Failure to repay any such loan or to pay interest thereon shall not void the policy until the total indebtedness hereon to the company shall equal or exceed the loan value at date of default, nor until one month after notice shall have been mailed by the company to the last known address of the insured and of the assignee, if any.

Loans without request of insured: If any premium hereon shall not be paid when due, and if no other surrender option has been chosen by the insured within the month of grace, the company will, without request on the part of the insured, charge the amount then due hereunder as a loan against the policy, with interest in advance at a rate not exceeding six per centum per annum, if the loan value hereon at date such premium was due is sufficient to secure all indebtedness hereunder, with interest. If the premium is so charged, this policy will be continued in force the same in all respects as though said loan had been requested by the insured. The same benefit will be applied from time to time as the premiums become due hereunder and are not paid, as long as the balance of the loan value hereon at the last date of nonpayment of premium is sufficient to pay for one day's insurance on a pro rata basis.

If the entire loan value of the policy is applied as hereinabove provided, the value of any and all matured, outstanding coupons,
to the credit of this policy in cash, will be further applied
18 to continue this policy in force in the same manner and upon
the same conditions as the loan value, upon surrender of such coupons to the company.

Notice of such loans will be mailed to the insured when made, and to the assignee, if any is recorded on this policy, and said insured may resume the payment of premiums hereon at any time, without medical reexamination, while the policy is so continued in force. The indebtedness hereon may be repaid wholly or in part in cash, or may be allowed to remain as a loan against the policy.

In any settlement of the policy the indebtedness to the company hereon shall be a first lien in priority to the claim of any beneficiary or assignee.

Decreasing premiums: At the option of the insured, the values represented by any or all of the coupons originally attached hereto, may be applied by the insured to reduce the premiums due and payable hereunder, as the premiums and coupons become due.

If the insured shall elect to apply this option, the amount due the company in any policy year will be the premium shown in the consideration paragraph herein, less the amount of the coupon due on the same date as the premium from which it is deducted. The balance shall be due the company in cash and the coupon then due shall be returned therewith for cancellation.

If the premiums hereunder are paid semiannually or quarterly the pro rata value of any coupon shall be applied as said premiums are paid.

Guaranteed surrender options: After three full years' premiums have been paid hereon, if any subsequent premium is not paid when due, the insured, upon surrender of this policy and all coupons not yet due to the company, and upon written request, both within the month of grace, shall be entitled to one of the following options:

1st. Cash: A cash payment equal to the loan value hereon at the date of default.

2nd. Paid-up insurance: A paid-up insurance policy payable at the same time and under the same conditions as this policy.

19 3rd. Extended insurance: A term insurance policy for the full amount of this policy.

The amounts of the loan or cash values and paid-up insurance and the term of the extended insurance are shown in columns 1, 2, and 3, respectively, of the table of guaranteed loan and surrender value shown herein, and are, without exception, equal or equivalent to the entire reserve hereon at the date of default, according to the American Experience Table of Mortality, with interest at the rate of three and one-half per centum per annum, less a surrender charge in no case exceeding two and one-half percent of the face of the policy.

Additional values not shown in the table will be allowed for parts of a policy year's premiums paid, and the values for later years not shown in the table, if a paid-up policy is then selected, will be equal or equivalent to the entire reserve on the policy.

The cash value of any and all matured, outstanding coupons, to the credit of this policy in cash at the date of default, will be paid to the insured, upon selection by said insured of one of the above three options and the surrender of said coupons to the company.

Table of guaranteed loans and surrender values

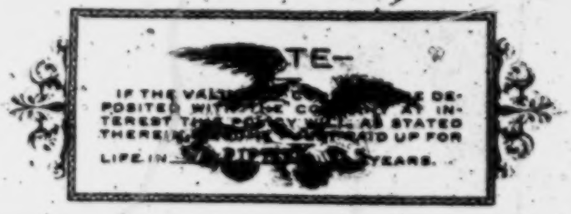
Exclusive of the cash value of any matured outstanding coupons

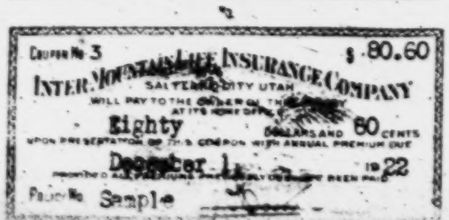
The following table is for a policy whose face value is $1,000. If the face value of this policy is more or less than $1,000, the values in column 1 and column 2 will apply pro rata. The amounts in column 3 will be unchanged by the amount of insurance.

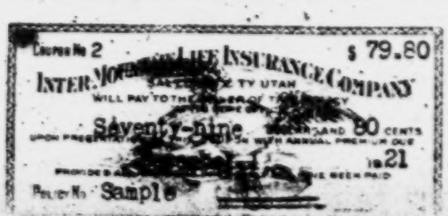
Cash Value of Coupons

Paid-Up Additions:—At any time during the first policy year or within one month after the due date of the second annual premium, the Insured, upon written request to the Company, may elect to convert the coupons originally attached hereto, as said coupons mature, into Paid-up Life Additions to this Policy for the amounts shown on the reverse side of the coupons. Said Paid-up additions shall not, however, be doubled in value in the event of the accidental death of the Insured.

If this option is selected each coupon must be surrendered to the Company within one month of its due date, together with payment of the annual premium due on same date in full in cash.







(4)

Tab. 7 of Guaranteed Increased Loan and Non-Forfeiture Values

Available only if there be no indebtedness upon the policy and premiums are paid in full in cash and if the paid-up addition option is in force, as provided on page three hereof. (The amounts shown in this table are for a $1000 policy. If this policy is for more or less than $1000, such amounts will apply pro rata.)

YEARS PREMIUM PAID	CASH OR LOAN VALUE	PAID-UP LIFE INSURANCE	AMOUNT PAYABLE AT DEATH
1	$		$1,000
2		$ 22	1,022
3	80	153	1,044
4	91	228	1,068
5	130	305	1,086
6	156	380	1,110
7	156	455	1,133
8	334	534	1,156
9	371	609	1,179
10	512	685	1,203
11	307	761	1,227
12	400	838	1,253
13	448	916	1,277
14	496	992	1,303
15	545	1,071	1,329
16	600	1,147	1,355
17	653	1,228	1,382
18	711	1,304	1,409
19	770	1,385	1,437
20	833	1,465	1,465

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Eighty Dollars
PAYABLE AT DEATH 19 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

NOTE—
THE CASH VALUE OF PAID-UP
ADDITIONS SHOWN HEREON WILL BE
THE KNOWN RESERVE ON SAID
ADDITIONS

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Seventy Dollars
PAYABLE AT DEATH 16 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Seventy Dollars
PAYABLE AT DEATH 17 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Eighty Dollars
PAYABLE AT DEATH 18 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Sixty Dollars
PAYABLE AT DEATH 13 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Sixty Dollars
PAYABLE AT DEATH 14 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Sixty Dollars
PAYABLE AT DEATH 15 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Forty Dollars
PAYABLE AT DEATH 10 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Fifty Dollars
PAYABLE AT DEATH 11 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Fifty Dollars
PAYABLE AT DEATH 12 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Thirty Dollars
PAYABLE AT DEATH 7 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Thirty Dollars
PAYABLE AT DEATH 8 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Forty Dollars
PAYABLE AT DEATH 9 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
PAYABLE AT DEATH 4 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
PAYABLE AT DEATH 5 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Thirty Dollars
PAYABLE AT DEATH 6 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
PAYABLE AT DEATH 1 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
PAYABLE AT DEATH 2 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
PAYABLE AT DEATH 3 IN ADDITION TO
THE PRINCIPAL SUM INSURED, BUT
RECONVERTIBLE AT ANY TIME
INTO ITS CASH VALUE

Years' premiums paid	Column 1, cash or loan value	Column 2, paid-up insurance	Column 3, extended insurance for face amount	
			Years	Days
3	$43	$109	4	348
4	65	162	7	179
5	89	217	10	49
6	113	270	12	180
7	138	322	14	221
8	165	378	16	201
9	192	430	18	55
10	220	482	19	196
11	249	534	20	274
12	279	586	21	209
13	311	639	22	312
14	343	689	23	277
15	377	742	24	265
16	412	792	25	271
17	449	846	26	352
18	486	895	28	142
19	525	948	30	197
20	566	1,000	Life	

23 Exhibit A, page 5

Incontestability: This policy and the application therefor constitute the entire contract between the insured and the company and shall be incontestable for any cause after two years from the date of issue, except for nonpayment of premiums or for violation of the provision relating to military or naval service.

If during the first policy year the insured shall suicide, whether sane or insane, the company shall be liable only for the cash premiums actually paid hereon.

All statements made by the insured shall, in the absence of fraud, be deemed representations and not warranties, and no such statement shall be used to void the policy or in defense of a claim hereunder unless said statement is contained in the written application herefor.

If the age of the insured has been misstated, the amount payable under this policy shall be the amount which the premium actually paid would have purchased at the correct age.

Military or naval service: During the first ten years of this policy, military or naval service in time of war is a risk not assumed by the company unless the insured shall give notice thereof to the company within thirty-one days after entering on such service, and pay such extra premiums as the company may fix therefor. In event of the insured entering upon such service and failing to give such notice, or failing to pay such extra premiums at the times and in the manner required, the liability of the company for death of the insured during such period of ten years, while engaged in or as a result of such service, shall be limited to the return of the premiums paid on this policy, less any indebtedness hereon to the company.

Payment of premiums: All premiums hereon after the first are payable in advance, either at the home office of the company or to an agent, on the delivery of a receipt signed by the president or secretary of the company. Any part of the then current policy year's premium unpaid at the death of the insured shall be deducted from the amount payable hereunder.

No officer other than those above stated, and no agent, has the power to make or to modify this or any other contract of the
24 company in any respect whatever, and the company is not responsible for, and shall not be bound by, any promises or representations made by any person other than the officers named, and then not unless said promises or representations are in writing and signed by one of the officers stated.

If any premium or note or installment thereof or other obligation given for all or a part of any premium or other indebtedness, is not paid on or before the date when due, the liability of the company hereunder shall cease, except as otherwise provided herein.

The premium is considered as payable annually in advance; but premiums after the first may be paid in semiannual or quarterly installments at the company's rates therefor, printed on the back of this policy. Any unpaid premium required to complete the payments for the current policy year in which death occurs shall be deducted from the amount payable hereunder.

Grace in payment of premiums: A period of grace of one month (not less than thirty days) will be allowed for the payment of every premium hereunder after the first without any interest charge therefor, during which month the full insurance hereunder shall continue in force.

Reinstatement: If, in the event of default in any premium payment hereon, the value of this policy shall be applied to the purchase of paid-up insurance or extended insurance, and if such paid-up insurance or extended insurance shall be in force, this policy may be reinstated at any time, upon evidence of insurability satisfactory to the company and the payment of arrears of premiums, with compound interest thereon at a rate not exceeding six per centum per annum. The indebtedness hereon, if not greater than the loan value at the date of reinstatement, may be allowed to remain as a loan against the policy, subject to interest.

Method of change of beneficiary: At any time while this policy is in force, the insured, if there be no existing assignment of the policy filed at the home office of the company as herein provided, may designate a new beneficiary or beneficiaries, without obtaining the consent of any beneficiary hereunder, by filing such request at the
home office upon the form of the company for this purpose,
25 accompanied by the policy for endorsement thereon. Such change shall become effective only when said endorsement is made on the policy by the company, whereupon the rights of any former beneficiary or beneficiaries shall cease. If no beneficiary

hereunder is living at the death of the insured, the proceeds of the policy will be paid to the executors, administrators, or assigns of the insured.

Assignment: This policy may be assigned by the insured, but no such assignment shall be binding upon the company until a duplicate copy thereof, upon the company's form, has been filed at the home office, and the company shall not be responsible for the legality of any assignment, and any claim hereunder by an assignee shall be subject to proof of assignment and extent thereof.

Indebtedness: Any indebtedness to the company hereon will be deducted in any settlement hereunder upon the death of the insured or in the payment of any other benefit. If this policy shall lapse and there shall be an indebtedness hereon, the said indebtedness will be deducted from the cash value of the policy at date of default, shown in column 1, and the balance will be (A) paid to the insured in cash, or (B) applied to the purchase of a paid-up insurance policy, payable at death, or (C) applied to purchase a term insurance policy for the face amount hereunder, at the request of said insured and the surrender of this policy during the month of grace, and said values shall be calculated upon the same basis as the values herein shown in the table of guaranteed loans and surrender values.

Rights of the insured: It is understood and agreed that the insured may obtain every benefit, exercise every right, and enjoy every privilege conferred upon said insured by this policy, without the consent of any beneficiary.

Methods of payment of death benefit: The amount insured by this policy, unless otherwise requested by the insured, will be paid in one sum as provided on page one hereof.

The insured, however, during his lifetime, or the beneficiary after the death of the insured, in case the insured has made no selection, may, if this policy is not then assigned, and upon request to the company on the proper form, change the method of payment hereof, by selecting any one of the following benefits:

26 Benefit one—Trust fund: The amount insured, or any portion thereof not less than one thousand ($1,000) dollars, may be left during the lifetime of the beneficiary in trust with the company, and the company will annually pay interest thereon at the rate of three and one-half per centum per annum, so long as the said amount insured or said portion thereof remains with the company. The said trust fund will be paid at the death of the beneficiary to the executors, administrators or assigns of the beneficiary, and may be withdrawn at any time with accrued interest, unless the company is otherwise directed in the request selecting this benefit.

The trust fund privilege may not be selected if the beneficiary under this policy be a corporation or a firm.

Benefit two—Annual income for number of years stated: The following table is for each $1,000 of the amount insured. To find the annual income on this policy, multiply the annual income per $1,000,

shown in the table, by the number of thousands insured by this policy.

Number of years	30	25	[1]20	15	10	5	4	3	2
Annual income per $1,000	$52	58	68	84	116	214	264	345	508

The first income will be paid immediately after receipt of due proofs of the death of the insured, and the remaining payments annually thereafter.

Benefit three—Monthly income during lifetime of beneficiary: The following table is for each $5,000 of the amount insured. To find the monthly income on this policy multiply the monthly income for each $5,000, shown in the table, by the number of times five thousand is insured by this policy.

Two hundred and forty monthly payments, at least, will be paid, in any event, covering a period of twenty years, and the monthly income will continue during the entire lifetime of the beneficiary, should the beneficiary survive said period of twenty years.

27 Age of beneficiary at death of insured	Monthly income for each $5,000	Age of beneficiary at death of insured	Monthly income for each $5,000
10 or under	$16.75	40	$21.35
11	16.80	41	21.60
12	16.90	42	21.85
13	17.00	43	22.10
14	17.10	44	22.40
15	17.20	45	22.70
16	17.25	46	23.00
17	17.35	47	23.30
18	17.45	48	23.60
19	17.60	49	23.90
20	17.75	50	24.20
21	17.85	51	24.45
22	17.95	52	24.70
23	18.10	53	24.95
24	18.25	54	25.20
25	18.40	55	25.45
26	18.55	56	25.75
27	18.70	57	26.00
28	18.85	58	26.25
29	19.05	59	26.50
30[1]	19.20	60	26.75
31	19.35	61	26.95
32	19.50	62	27.15
33	19.70	63	27.30
34	19.90	64	27.40
35	20.15	65	27.50
36	20.35	66	27.55
37	20.55	67	27.60
38	20.80	68	27.65
39	21.05	69 and over	27.70

[1] Illustration: If at the death of the insured, the beneficiary shall be thirty years of age last birthday, the amount of each monthly payment under this policy will be nineteen dollars and twenty cents ($19.20) for every five thousand dollars insured by this policy, said monthly income continuing for at least twenty years and as much longer as the beneficiary shall survive.

28 The first monthly income will be paid immediately after receipt of due proofs of the death of the insured, and succeeding incomes on the first day of each month thereafter.

This benefit may not be selected if there is more than one beneficiary under this policy, nor if the amount insured hereby is less than two thousand five hundred ($2,500) dollars.

[1] Illustration: If an annual income for twenty years is selected, the amount of each annual payment will be sixty-eight ($68.00) dollars for each thousand dollars insured by this policy. Any term of years shown in the above table may be selected.

INTER-MOUNTAIN LIFE
INSURANCE COMPANY

SALT LAKE CITY, UTAH.

John Doe

No Sample

Age 35

Amount	$ 10,000.00
Annual Premium	$ 420.90
Semi Annual	$ 218.90
Quarterly	$ 111.50

Premium Payable Annually

on the First day of December

NOTICE - No receipt issued for the initial collecting the insurance or any benefit under this policy unless application shall be made direct to the Home Office.

20-Payment Life Coupon—Non Participating.

REGISTER OF CHANGE OF BENEFICIARY

NOTE—No notice of Change of Beneficiary or the assignment of this Policy by the Company at the Home Office shall take effect until endorsed on this Policy by the Company at the Home Office.

DATE ENDORSED	BENEFICIARY	ENDORSED BY

Subject to the conditions printed herein, this draft will be paid at the company's home office in Salt Lake City, Utah.

PRESIDENT

ISSUED BY

INTER-MOUNTAIN LIFE INSURANCE COMPANY

SALT LAKE CITY, UTAH.

ONE HUNDRED

SUBJECT TO THE FOLLOWING CONDITIONS WHICH ARE HEREBY MUTUALLY AGREED TO

No. 100 Dollars $100.00

TO INTER-MOUNTAIN LIFE INSURANCE CO.

SALT LAKE CITY, UTAH.

Dated at _____ State of _____

This _____ Day of _____ 19__

To the Beneficiary. In case of death of the insured, take this policy together with all receipts and proofs and fill in the name of the bank on the face and in accordance with the terms of the draft, sign and get $100.00 at said bank without delay. Cut out this draft, sign it and

W. Smith. Pay to the order of _____ Name of Bank

Which sum shall be paid by it in conformance thereto and charge the Insured under Policy No. _____

Beneficiary Sign Here

ab

General: The insured may, at any time change his selection of the "Methods of payment of death benefit" under this policy; he may also revoke all selections, thereby making this policy again payable in one sum.

If, upon the selection of benefit two or benefit three above, the beneficiary shall die before all the payments due thereunder have been made, the remainder of said payments will continue to be paid as selected by the insured under this policy, or, if the insured has made no such selection, will be commuted at three and one-half per centum compound interest and paid in one sum to the executors, administrators, or assigns of the beneficiary.

If the insured so directs during his lifetime, the beneficiary may neither assign nor commute any payments hereunder before same are due. No selection, change, or revocation of any one of the above benefits shall take effect until endorsed on this policy by the company at its home office. After endorsement this policy will be returned to the insured.

30 Before U. S. Board of Tax Appeals

Excerpt from transcript of hearing of Nov. 16, 1932, showing opinion of Board

The member: In view of the fact that the only remaining issue in the case for disposition is the one issue which has already been decided, as you both agree, by the Board in the Standard case and the Reserve case and the Western Union case, and by the Circuit Court of Appeals for the Ninth Circuit in the Western Union case affirming the Board, and of the Third Circuit in the Standard case affirming the Board and the appeal in the Reserve case has been dismissed at the behest of the Government, upon the facts as now stipulated, I will decide this case in favor of the petitioner and direct counsel, in accordance with their stipulation, to submit a judgment under rule 50.

I do this because your stipulation of facts makes it unnecessary to make any finding of facts and the existing authorities makes the question itself clear enough.

Before U. S. Board of Tax Appeals

Judgment

Subsequent to the Board's decision rendered at the close of the hearing on November 16, 1932, which appears in the transcript of record, the respondent filed a proposed judgment which the petitioner agrees is in conformity with said decision. In accordance therewith, it is

Ordered, adjudged, and decided that there is a deficiency in income tax for 1922 of $115.22.

(Signed) JOHN M. STERNHAGEN,
Member.

Entered April 8, 1933.

Before U. S. Board of Tax Appeals

Petition for review and assignments of error

Filed July 3, 1933

To the Honorable Judges of the United States Circuit Court of Appeals for the Tenth Circuit:

Now comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Sewall Key, head, Tax Section, Department of Justice, E. Barrett Prettyman, general counsel, Bureau of In-
31 ternal Revenue, and James C. Maddox, special attorney, Bureau of Internal Revenue and respectfully shows:

I

The petitioner on review (hereinafter referred to as the petitioner), is the duly appointed and qualified Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States. The respondent on review (hereinafter referred to as respondent), is a corporation organized and existing under the laws of the State of Utah, with its principal office and principal place of business in Salt Lake City, State of Utah. The Federal income-tax return of respondent for the calendar year 1922 was filed with the collector of internal revenue for the collection district of Utah, located in Salt Lake City, State of Utah, which said collection district is located within the Tenth Judicial Circuit of the United States.

II

The nature of the controversy is as follows:

The respondent is a capital stock life insurance company which, during the calendar year 1922 and for a long time prior thereto, was engaged in the business of issuing life insurance contracts in Utah, Idaho, and Arizona. Its books of account and its Federal income-tax return for the calendar year 1922 were upon a cash receipts and disbursements basis. Among the insurance contracts that it issued were those denominated "20-payment life coupon policy—nonparticipating." Each of such "20-payment life coupon policies—nonparticipating", was issued with 19 coupons attached thereto, the coupons maturing serially on anniversary dates of the policy, beginning with the first anniversary and ending with the 19th, providing the premiums for the policy year beginning on the date of the coupon and all premiums previously due had been paid. Each coupon upon its maturity is a promise that the amount thereof will be paid to the owner of the policy. By the terms of the policy, the insured is given certain elections and options respecting such unpaid matured coupons among which is the option that if any premium after the first is paid to the company in full in cash and the amount of the cou-

pon is deposited with the company at interest, the company
32 will credit to the insured the face amount of any matured coupon as such coupon becomes due and agrees to pay compound interest thereon at the rate of 3½ per centum per annum from the maturity date of the coupon until it is paid. The amount thus credited to the insured on account of unpaid matured coupons plus compound interest thereon may be applied to the payment of premiums or withdrawn in cash at any time by the insured. If the amounts represented by the first 14 coupons attached to the policy when issued are left on deposit with the company at compound interest as aforesaid, the company will, at the end of 15 years from the date of such 20 payment life coupon policy, upon written request of the insured, issue in lieu of such 20-payment life coupon policy a fully paid-up policy for the full face amount of the insurance named in such 20-payment life coupon policy upon surrender to the company of that policy and all of the coupons originally attached thereto. If the amount represented by the coupons is not applied to the payment of premiums or withdrawn in cash by the insured and is not used to secure a fully paid-up policy as hereinabove stated, then, upon the death of the insured while such 20-payment life coupon policy is in full force, the amount of any unpaid matured coupons with interest to date of death will be paid to the beneficiary in addition to the face amount of such 20-payment life coupon policy upon surrender to the company of that policy and all coupons issued therewith and unpaid or unmatured prior to the date of the death of the insured.

The liability of respondent for amounts which had been left on deposit with the company to accumulate at interest represented by unpaid matured coupons attached to "20-payment life coupon policies—nonparticipating", then in force and the compound interest thereon from the maturity date of each coupon was, on January 1, 1922, $126,949.03. On December 31, 1922, the amount of such liability was $146,097.75. In its Federal income tax return for the calendar year 1922, respondent claimed a deduction of 4% of the mean of its liability for amounts left on deposit with it to accumulate at interest represented by unpaid matured coupons attached to "20-payment life coupon policies—nonparticipating", and such deduction was disallowed by petitioner. As a result of this disallowance together with other adjustments not now in controversy, petitioner determined a deficiency in Federal income taxes for the
33 calendar year 1922 in the amount of $1,903.50 and on October 14, 1926, sent to respondent by registered mail a notice of said deficiency. Thereafter respondent duly appealed from said notice of deficiency to the United States Board of Tax Appeals. Said appeal was heard by said Board on November 16, 1932, and at the conclusion of such hearing said Board orally decided the issue here involved, sustaining the contention of respondent on review. On April 8, 1933, said Board entered its decision wherein it ordered and decided that there was a deficiency due from respondent for the calendar year 1922 in the amount of $115.22. Said Board held that the

liability of respondent for amounts left on deposit with it to accumulate at interest represented by unpaid matured coupons attached to "20-payment life coupon policies—nonparticipating", and the compound interest thereon, was a reserve fund required by law and permitted the deduction of 4% of the mean of such liability from gross income.

III

The petitioner says that in the record and proceedings before the United States Board of Tax Appeals and in the findings of fact, opinion, and decision promulgated and entered by said Board of Tax Appeals manifest error occurred and intervened to the prejudice of the petitioner and the petitioner assigns the following errors:

1. The Board erred in holding that the respondent's liability upon matured premium-reduction coupons was a reserve fund required by law within the meaning of section 245(a)(2) of the Revenue Act of 1926.

2. The Board erred in permitting the respondent to deduct from its gross income of the calendar years 1925 and 1926 four per cent of the mean at the beginning and end of each taxable year of its liability upon matured premium-reduction coupons. Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Tenth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said court and transmitted to the clerk of said court for filing, and that appro-
34 priate action be taken to the end that the errors complained of may be reviewed and corrected by said court.

(Sgd.) SEWALL KEY,
Head, Tax Section, Department of Justice.
(Signed) E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue.

Of Counsel: (Sgd.) James C. Maddox, special attorney, Bureau of Internal Revenue.

11d 7/1/33.

[*Duly sworn to by James C. Maddox, jurat omitted in printing.*]

Before U. S. Board of Tax Appeals

Notice of filing petition for review

Filed July 5, 1933

To: Abraham R. Serven, Esq., Kellogg Building, 1422 F Street N. W., Washington, D. C.

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of July 1933, file with the clerk of the United States Board of Tax Appeals, at Washington, D. C., a

petition for review by the United States Circuit Court of Appeals for the Tenth Circuit, of the decision of the Board heretofore
35 rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this day of July 1933.

(Signed) E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 3rd day of July 1933. (Sgd.) Robert Serven, attorney for respondent on review.

Before U. S. Board of Tax Appeals

Notice of filing petition for review

Filed July 13, 1933

To: Inter-Mountain Life Insurance Company, Twelfth Floor, Continental Bank Building, Salt Lake City, Utah.

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of July 1933, file with the clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Tenth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 3rd day of July 1933.

(S.) E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 5 day of July 1933. (Sgd.) Inter-Mountain Life Ins. Co., by A. S. Baker, asst. secy. & asst. treas.

Before U. S. Board of Tax Appeals

Stipulation amending assignments of error

Filed July 21, 1933

It is hereby stipulated, by and between counsel for the
36 parties hereto, respectively, that the assignments of error in the above-entitled cause be, and the same hereby are, amended to correct errors appearing therein as follows:

Assignment of error no. 1, substitute "Revenue Act of 1921" for "Revenue Act of 1926."

Assignment of error no. 2, substitute "calendar year 1922" for "calendar years 1925 and 1926", so that the assignments of error read as follows:

1. The Board erred in holding that the respondent's liability upon matured premium-reduction coupons was a reserve fund required by law within the meaning of section 245 (a) (2) of the Revenue Act of 1921.

2. The Board erred in permitting the respondent to deduct from its gross income of the calendar year 1922 four per cent of the mean at the beginning and end of each taxable year of its liability upon matured premium-reduction coupons.

(Sgd.) PAT MALLON,
Assistant Attorney General.
(Signed) E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue,
Attorney for Petitioner.
(Sgd.) GUY PATTEN,
Attorney for Respondent.

11d 7/19/33.

Before U. S. Board of Tax Appeals

Præcipe for record

Filed Nov. 11, 1933

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver to the clerk of the United States Circuit Court of Appeals for the Tenth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Tenth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.

2. Pleadings before the Board,

37 (a) Amended petition, including annexed copy of deficiency letter.

(b) Answer to amended petition.

(c) Amendment to answer to amended petition.

3. Copy of minutes of the Board, showing opinion of Board as orally delivered.

4. Judgment and decision of the Board.

5. Petition for review, together with proof of service of notice of filing petition for review, and of service of a copy of petition for review, and stipulation amending petition for review.

6. Stipulation of facts.

7. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record.

8. This praecipe. (Signed) E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 10 day of Nov. 1933. (Sgd.) A. R. Serven, attorney for respondent. 11d 10/10/33.

[Clerk's certificate to foregoing transcript omitted in printing.]

38, 39 [Minute entry of argument and submission, April 16, 1934, omitted in printing.]

40 In United States Circuit Court of Appeals, Tenth Circuit

No. 1003. Special June term, 1934

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

INTER-MOUNTAIN LILE INSURANCE COMPANY, RESPONDENT

On petition to review the decision of the United States Board of Tax Appeals

June 11, 1934

Edward H. Horton, Spec. Asst. to the Atty. Genl. (Frank J. Wideman, Asst. Atty. Genl., and Sewall Key, Spec. Asst. to the Atty. Genl., were with him on the brief) for the petitioner. Delos C. Johns (Charles E. McLaughlin, Homer H. Berger, and Abram R. Serven were with him on the brief) for the respondent.

Opinion

Before PHILLIPS, MCDERMOTT, and BRATTON, Circuit Judges

MCDERMOTT, *Circuit Judge*, delivered the opinion of the court:

Consistent with its many rulings on the point, the Board of Tax Appeals allowed respondent a deduction in its 1922 return
41 (Rev. Act 1921, § 245 (a) (2)) on account of reserve funds held to meet its liabilities to holders of matured unsurrendered and unpaid coupons attached to its twenty-payment life coupon nonparticipating policies. The Commissioner has petitioned to review.

Respondent is a Utah corporation. Nineteen coupons are attached to a policy which is fully paid in twenty years—one maturing each policy year after the first. Each is a promise to pay the amount thereof to the policyholder in event all premiums due at the maturity of the coupon have been paid. The insured may use any coupon to purchase additional paid-up insurance. Coupons which have been paid, or which have been used to purchase such additional insurance, are not here involved. We are here concerned only with matured but unsurrendered coupons.

Such coupons may be withdrawn in cash, with interest, at any time after maturity. But they need not be. The insured may, at his own option, use them to mature the policy at the end of twenty years for

$14,130 instead of $10,000, if he is then insurable; or at the end of twenty years, without medical examination, use them to purchase an annuity of $174.40 payable during his life; or, without medical examination, use the first fourteen coupons to mature the policy for the full $10,000 at the end of fifteen years instead of twenty. In short, the company has agreed to issue life insurance or an annuity to the policyholder in exchange for his coupons, at the option of the insured. The reserves in question are set up against that contingent liability to the policyholder. Until the insured elects to withdraw in cash, the company faces the contingent liability of their conversion into life insurance.

In his brief, the Commissioner concedes that the Utah statutes require reserves to be set up against the liabilities on such coupons. It is contended that such reserves are not the technical reserves contemplated by the taxing statutes.

The same argument, supported by the same authorities, was addressed to this court in Commissioner v. Great American Life Insurance Company, 70 F. (2d) 133. The present case is con-
42 cededly indistinguishable. Counsel, with commendable frankness, insists that our opinion in that case, similar opinions by the Third and Ninth Circuits, and the numerous decisions on the precise point by the Board of Tax Appeals, are all wrong. Perhaps they are, although counsel's brief serves only to fortify our belief in the soundness of these opinions. But if they are all wrong, the orderly way is to petition the Supreme Court for certiorari. The Supreme Court may not grant certiorari, it is true, in the absence of a conflict between the Board and any circuit. But we cannot decide a case contrary to our convictions in order to supply such a conflict.

Notwithstanding a proper reluctance to reexamine a point just decided after mature consideration, we have studied the briefs submitted. Nothing new is added to the arguments heretofore passed on. We are still of the opinion that a liability which may be converted into life insurance at the option of the insured, is one against which a technical reserve must be set up, if the laws of the states are to afford any security to those who invest their savings in life insurance.

The petition to review is denied.

43 In United States Circuit Court of Appeals

Judgment

June 25, 1934

Before Honorable Robert E. Lewis and Honorable Orie L. Phillips, Circuit Judges

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the petition for review of the decision of the said United States Board of Tax Appeals in this cause be, and the same is hereby, denied; and that the decision of the said United States Board of Tax Appeals in this cause be and the same is hereby affirmed.

Recital as to issuance of mandate

(On July 31, 1934, the mandate of the United States Circuit Court of Appeals, in accordance with the opinion and judgment of said court, was issued to the United States District Court.)

44 [Clerks certificate to foregoing transcript omitted in printing.]

45 In Supreme Court of the United States

Order extending time within which to apply for writ of certiorari

Filed Sept. 21, 1934

On consideration of the motion of counsel for the United States in the above-entitled case, and good cause therefor having been shown, it is now here ordered that the time within which a petition for writ of certiorari may be filed herein be and the same is hereby extended for a period of 60 days from September 25, 1934.

Dated this 21st day of September 1934.

J. C. McREYNOLD,

Associate Justice of the Supreme Court of the United States.

45½ [File endorsement omitted.]

46 Supreme Court of the United States

Order allowing certiorari

Filed January 7, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

47 (Endorsement on cover:) File No. 39, 165. U. S. Circuit Court of Appeals, Tenth Circuit. Term No. 537. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. Inter-Mountain Life Insurance Company. Petition for a writ of certiorari and exhibit thereto. Filed November 22, 1934. File No. 537 O. T. 1934.

U. S. GOVERNMENT PRINTING OFFICE: 1935

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CITATIONS

Cases:

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McCoach v. *Insurance Co. of N. Amer.*, 244 U. S. 585 — 9

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Revenue Act of 1924, c. 234, 43 Stat. 253:
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Revenue Act of 1926, c. 27, 44 Stat. 9:
Sec. 245 (U. S. C. App., Title 26, Sec. 1004) — 2

Revenue Act of 1928, c. 852, 45 Stat. 791:
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Revenue Act of 1932, c. 209, 47 Stat. 169:
Sec. 203 (U. S. C. Sup. VII, Title 26, Sec. 203) — 2

Revised Statutes of Utah, 1933, Title 43:
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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

INTER-MOUNTAIN LIFE INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Tenth Circuit entered in the above case on June 25, 1934, affirming a decision of the United States Board of Tax Appeals.

OPINION BELOW

The Board of Tax Appeals rendered no opinion. See Record, p. 30. The opinion of the Circuit Court of Appeals is reported in 71 F. (2d) 962.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 25, 1934. By an order entered

by a Justice of this Court on September 21, 1934, the time for filing a petition for a writ of certiorari was extended for a period of sixty days from September 25, 1934.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts held by respondent, a life insurance company, at the beginning and end of the calendar year 1922, to meet its liabilities to the holders of matured, unsurrendered, and unpaid coupons attached to certain insurance-policy contracts denominated "20-Payment Life Coupon Policy—Non-Participating" constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.[1]

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 11–14.

STATEMENT

The facts in the case were stipulated (R. 10–29), and may be summarized as follows:

---

[1] Section 245 (a) (2) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 261, was reenacted without substantial change in the Revenue Acts of 1924 (c. 234, 43 Stat. 253; U. S. C., Title 26, Sec. 1004) and 1926 (c. 27, 44 Stat. 9; U. S. C. App., Title 26, Sec. 1004); and as Section 203 (a) (2) of the Revenue Acts of 1928 (c. 852, 45 Stat. 791) and 1932 (c. 209, 47 Stat. 169; U. S. C. Sup. VII, Title 26, Sec. 203 (a) (2)).

Respondent is a capital stock life insurance company, organized in the year 1911 under the laws of the State of Utah, and during the year 1922 and prior thereto was engaged in the business of issuing life insurance contracts in Utah, Idaho, and Arizona (R. 11).

Among the policies of life insurance issued by respondent were certain policy contracts denominated "20-Payment Life Coupon Policy—non-participating", each of said policies having nineteen coupons attached thereto, maturing serially on anniversary dates of the policy beginning with the first and ending with the nineteenth (R. 11).

Each coupon is a promise that at its maturity and upon the payment of the premium then due, respondent will pay the amount of the coupon to the owner (R. 11). A specimen copy of such coupon reads on its face (R. 21):

Coupon No. 1 $78.90

INTER-MOUNTAIN LIFE INSURANCE COMPANY
Salt Lake City, Utah
Will pay to the owner of this policy
at its home office
Seventy-eight dollars and 90 cents
Upon presentation of this coupon with
annual premium due
December 1, 1920
Provided all premiums previously due
have been paid
Policy No. *Sample.*

----------,
President.

The reverse side of the coupon reads (R. 22):

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
Payable at death in addition to
the principal sum insured but
RECONVERTIBLE AT ANY TIME
into its cash value.

By the terms of these coupon policies the insured is given certain elections and options respecting such coupons among which it is provided that respondent will credit to the insured the face amount of any matured coupon, as said coupon becomes due, and will pay compound interest thereon at the rate of 3½ per centum per annum, thereby creating a fund to the credit of the insured, which amount may be applied to the payment of premiums or withdrawn in cash at any time by the insured, and if not so applied or withdrawn by the insured prior to his death, the values represented by the coupons, with interest to date of death, will, in the event of the death of the insured while the policy is in force, be paid to the beneficiary, in addition to the face amount of the policy, upon surrender to the respondent of the policy and all coupons issued therewith and unpaid or unmatured prior to the date of said death (R. 11).

Pursuant to the terms of these coupon policies, the insured, at any time during the first policy year or within one month after the due date of the second annual premium, may, in writing, elect to convert the coupons originally attached to such poli-

cies, as such coupons mature, into paid-up life additions to the policy for the amount shown on the reverse side of each coupon, and each coupon must then be surrendered to the respondent within one month after its due date, and payment of the annual premium due on the same date made in full in cash. When the coupon is so surrendered for paid-up additions to the policy and full premium paid, respondent issues to insured a letter of acknowledgment of his remittance and coupon in which it is stated that the amount of the paid-up life insurance has been effected. The paid-up addition to the policy is then only reconvertible into its cash surrender value. (R. 12.)

During the calendar year 1922 respondent paid to holders of matured coupons surrendered during that year the face amounts of such coupons, together with accrued interest thereon in the sum of $897.58. The Commissioner of Internal Revenue, in auditing respondent's income-tax return for 1922, allowed as a deduction the amount of interest paid, i. e., $897.58 on coupons theretofore left to accumulate at interest and surrendered during the tax year 1922. (R. 13.)

Said coupon policies further contained the following (R. 15):

GUARANTEED OPTIONS AT THE END OF TWENTY YEARS

If all the premiums due hereon as stated in the Consideration Paragraph herein are

paid to the Company in full in cash, and if as each coupon attached hereto matures, the amount thereof has been left with the Company to accumulate at interest, then upon the surrender of this policy and all coupons which are attached hereto at date of issue, the Insured shall select one of the following options at the end of twenty years from the date hereof:

1. A Guaranteed Cash Payment of Eight Thousand Dollars.

2. A Paid-up Policy for Life of Fourteen Thousand One Hundred Thirty Dollars, subject to satisfactory evidence of insurability for the excess over the original face amount of this Policy.

3. A Guaranteed Annual Income of Four Hundred Ninety Dollars, to continue for at least Twenty years and as many years thereafter as the Insured shall survive.

4. A Paid-up Policy for Life of Ten Thousand Dollars, without medical reexamination, and an Annual Income of $174.40 Dollars, payable annually thereafter during the life of the Insured.

And the following (R. 16):

Fully Paid-up Benefit: If all of the values represented by the first Fourteen coupons attached to this Policy at issue, are left on deposit with the Company at compound interest as aforesaid, the Company will, upon written request of the Insured hereunder, issue in lieu of this Policy a fully paid-up Policy for Ten Thousand Dollars ($10,000)

> at the end of Fifteen years from the date of this Policy, upon the surrender to the Company of this Policy and all of the coupons originally attached hereto.

On January 1, 1922, the amount of respondent's liability to the holders of *matured, unsurrendered,* and *unpaid coupons,* which had been left with respondent to accumulate at interest (in accordance with one of the options contained in the policies so to do), with accrued compound interest thereon, amounted to the sum of $126,949.03, and at December 31, 1922, to the sum of $146,097.75. The mean of these sums is $136,523.39, and this sum the Commissioner of Internal Revenue refused to include in respondent's "reserve funds required by law" for the year 1922. (R. 12.)

The Board of Tax Appeals sustained the contention of the respondent that the amounts held to meet its liabilities to the holders of matured, unsurrendered, and unpaid coupons constituted "reserve funds required by law" within the meaning of the Revenue Act, and the Circuit Court of Appeals denied the Commissioner's petition for review.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a liability which may be converted into life insurance at the option of the insured, but which has not been so converted during the tax year, is one against which a technical in-

surance reserve, such as is contemplated by Section 245 (a) (2) of the Revenue Act of 1921, may be set up and maintained.

2. In holding that amounts which had become unconditionally due and payable during the year 1922 to the holders of matured, unsurrendered, and unpaid coupons, and which had been left during said year with respondent to accumulate at interest, and accrued interest thereon, constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

3. In holding that amounts which had become unconditionally due and payable during the year 1922 to the holders of matured, unsurrendered, and unpaid coupons constituted a contingent liability of the respondent during said year.

4. In failing to hold that amounts which had been left with the respondent during the calendar year 1922, with accrued interest thereon, by the holders of matured, unsurrendered, and unpaid coupons did not constitute "reserve funds required by law" within the meaning of the Revenue Act of 1921, but were merely solvency reserves under the laws of the State of Utah.

5. In holding that the "legal reserves" required to be maintained by respondent during the year 1922 under the laws of the State of Utah included the amounts, with accrued interest thereon, held by respondent to meet its liabilities during said year to the holders of matured, unsurrendered, and unpaid coupons.

6. In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below is in direct conflict with the case of *Continental Assurance Co., Inc.* v. *United States,* decided October 15, 1934, in which the Court of Claims, expressly declining to follow the instant case, held that reserves maintained by a life-insurance company to meet its liabilities on matured, unsurrendered, and unpaid coupons attached to policies similar to those involved here were not "reserve funds required by law" within the meaning of the Revenue Acts.[2]

2. It is well settled that the term "reserve funds", as used in the Revenue Acts, has a technical meaning and does not include all reserves maintained pursuant to the requirements of state law or designated as such by state officials. *McCoach* v. *Insurance Co. of North America,* 244 U. S. 585; *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, as modified by *United States* v. *Boston Insurance Co.,* 269 U. S. 197; *New York Life Insurance Co.* v. *Edwards,* 271 U. S. 109, 119. The decision below holds, in effect, that reserves maintained by a life insurance company to meet its liabilities to holders of matured, unsurrendered, and unpaid

[2] The *Continental Assurance Co.* case has not been officially reported, but may be found in 1934 Prentice-Hall Federal Tax Service, par. 1902. For the convenience of the Court, printed copies of the findings of fact and opinion are being filed herewith.

coupons constitute part of the technical insurance reserves contemplated by the taxing Acts. We submit that this is inconsistent with the meaning attributed by this Court to the term "reserve funds" in the cases cited above, and that the decision below is incorrect.

3. The question presented is one of general importance, affecting as it does all life insurance companies issuing policies of life insurance of the type commonly known as "Premium Reduction Coupon Policies." It is important that the conflict of authority be resolved for the guidance of the courts and officers charged with the administration of the law. There are now pending more than fifteen cases involving this issue in the various Circuit Courts of Appeals and District Courts of the United States, as well as several additional appeals now pending before the Board of Tax Appeals.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

NOVEMBER 1934.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 261:

SEC. 245. (a) That in the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * *

Treasury Regulations 62:

ART. 681. *Reserve funds.*—Under paragraphs (1) and (2) of section 245 (a), life insurance companies are entitled to deduct from gross income: (1) Interest which is exempted in the case of other taxpayers by section 213 (b)(4) and articles 74–83; and (2) the excess, if any, of the reserve deduction specified in section 245 (a)(2) over the amount of such interest. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance. In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Only reserves peculiar to insurance companies are to be taken into consideration. Reserves "maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage" (*Maryland Casualty Co.* v. *United States,* 251 U. S., 342), will not be considered. A company is

permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7, 8, 9, 10, and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19, and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held.

Revised Statutes of Utah, 1933, Title 43:

CHAPTER 3

* * * * *

SEC. 4. *Capital to be Full-paid and Unimpaired.*—No stock company shall do any [life] insurance business in this state before its capital is fully paid up. Said capital must be unimpaired, that is, the assets of such company must equal or exceed all liabilities for losses reported, expenses, taxes and other outstanding *liabilities,* including *the legal reserves* as provided in sections 43–3–12 * * * (L. 21, p. 96, § 1144 [8]). (Italics supplied.)

* * * * *

SEC. 12. *Life Insurance—Valuation of Policies and Reserves.*—For the purpose of making valuations of life insurance policies and of determining the reserves required to be maintained therefor under the provisions of this title *the rate of interest assumed* shall be 3½ percent per annum, and the rate of mortality shall be established by the table known as the "American Experience Table of Mortality" for policies issued after January 1, 1910; * * * (C. L. 17, § 1153). (Italics supplied.)

U. S. GOVERNMENT PRINTING OFFICE: 1934

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 537

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

INTER-MOUNTAIN LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINION BELOW

The Board of Tax Appeals rendered no opinion. (See R. 19.) The opinion of the Circuit Court of Appeals (R. 25–26) is reported in 71 F. (2d) 962.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 25, 1934 (R. 26). By an order entered by a Justice of this Court on September 21, 1934, the time for filing a petition for a writ of certiorari was extended for a period of sixty days from September 25, 1934 (R. 27). The petition for

a writ of certiorari was filed November 22, 1934, and the writ was granted January 7, 1935 (R. 27). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts held by respondent, a life insurance company, at the beginning and end of the calendar year 1922, to meet its liabilities to the holders of matured, unsurrendered, and unpaid coupons attached to certain of its life insurance policies constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 43–46.

STATEMENT

The facts in the case were stipulated (R. 8–19), and may be summarized as follows:

Respondent is a capital stock life insurance company, organized in the year 1911 under the laws of the State of Utah, and during the year 1922 and prior thereto was engaged in the business of issuing life insurance contracts in Utah, Idaho, and Arizona (R. 8).

Among the policies of life insurance issued by respondent were certain policies denominated "20-Payment Life Coupon Policy—nonparticipating", each of said policies having nineteen coupons attached thereto, maturing serially on anniversary dates of the policy, beginning with the first and ending with the nineteenth, provided the premiums for the policy year beginning on the date of the coupon are paid and all premiums previously due have been paid (R. 8). The first coupon is not part of the first year's premium, which is solely for term insurance for the year (R. 11).

Each coupon is a promise that at its maturity, and upon the payment of the premium then due, respondent will pay the amount of the coupon to the owner (R. 8). A specimen copy of such coupon reads on its face (R. 14):

Coupon No. 1 $78.90

INTER-MOUNTAIN LIFE INSURANCE COMPANY
Salt Lake City, Utah
Will pay to the owner of this policy
at its home office
Seventy-eight dollars and 90 cents
Upon presentation of this coupon with
annual premium due
December 1, 1920
Provided all premiums previously due
have been paid
Policy No. *Sample.*

----------,
President.

The reverse side of the coupon reads (R. 14):

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
Payable at death in addition to
the principal sum insured but
RECONVERTIBLE AT ANY TIME
into its cash value

By the terms of these coupon policies the insured is given certain elections, and options respecting such coupons, among which it is provided that respondent will credit to the insured the face amount of any matured coupon, as said coupon becomes due, and will pay compound interest thereon at the rate of 3½ per centum per annum, thereby creating a fund to the credit of the insured, which amount may be applied to the payment of premiums or withdrawn in cash at any time by the insured, and if not so applied or withdrawn by the insured prior to his death, the values represented by the coupons, with interest to date of death, will, in the event of the death of the insured while the policy is in force, be paid to the beneficiary, in addition to the face amount of the policy, upon surrender to the respondent of the policy and all coupons issued therewith and unpaid or unmatured prior to the date of said death (R. 8–9).

Pursuant to the terms of these coupon policies, the insured, at any time during the first policy year or within one month after the due date of the second annual premium, may, in writing, elect to convert the coupons originally attached to such policies, as such coupons mature, into paid-up life

additions to the policy for the amount shown on the reverse side of each coupon, and each coupon must then be surrendered to the respondent within one month after its due date, and payment of the annual premium due on the same date made in full in cash. When the coupon is so surrendered for paid-up additions to the policy and full premiums paid, respondent issues to insured a letter of acknowledgment of his remittance and coupon in which it is stated that the amount of the paid-up life insurance has been effected. The paid-up addition to the policy is then only reconvertible into its cash surrender value. (R. 9.)

During the calendar year 1922 respondent paid to holders of matured coupons surrendered during that year the face amounts of such coupons, together with accrued interest thereon in the sum of $897.58. The Commissioner of Internal Revenue, in auditing respondent's income-tax return for 1922, allowed as a deduction the amount of interest paid, i. e., $897.58, on coupons theretofore left to accumulate at interest and surrendered during the tax year 1922. (R. 10.)

Said coupon policies further contained the following (R. 11):

> GUARANTEED OPTIONS AT THE END OF TWENTY YEARS
>
> If all the premiums due hereon as stated in the consideration paragraph herein are paid to the company in full in cash, and if as each coupon attached hereto matures, the amount thereof has been left with the com-

pany to accumulate at interest, then upon the surrender of this policy and all coupons which are attached hereto at date of issue, the insured shall select one of the following options at the end of twenty years from the date hereof:

1. A guaranteed cash payment of eight thousand dollars.

2. A paid-up policy for life of fourteen thousand one hundred thirty dollars, subject to satisfactory evidence of insurability for the excess over the original face amount of this policy.

3. A guaranteed annual income of four hundred ninety dollars, to continue for at least twenty years and as many years thereafter as the insured shall survive.

4. A paid-up policy for life of ten thousand dollars, without medical reexamination, and an annual income of $174.40, payable annually thereafter during the life of the insured.

And the following (R. 12):

Fully paid-up benefit: If all of the values represented by the first fourteen coupons attached to this policy at issue, are left on deposit with the company at compound interest as aforesaid, the company will, upon written request of the insured hereunder, issue in lieu of this policy a fully paid-up policy for ten thousand dollars ($10,000) at the end of fifteen years from the date of this policy, upon the surrender to the company of this policy and all of the coupons originally attached hereto.

On January 1, 1922, the amount of respondent's liability to the holders of *matured, unsurrendered,* and *unpaid coupons,* which had been left with respondent to accumulate at interest (in accordance with one of the options contained in the policies so to do), with accrued compound interest thereon, amounted to the sum of $126,949.03, and at December 31, 1922, to the sum of $146,097.75. The mean of these sums is $136,523.39, and this sum the Commissioner of Internal Revenue refused to include in respondent's "reserve funds required by law" for the year 1922. (R. 9.)

The Board of Tax Appeals sustained the contention of the respondent that the amounts held to meet its liabilities to the holders of matured, unsurrendered, and unpaid coupons constituted "reserve funds required by law" within the meaning of the Revenue Act, and the Circuit Court of Appeals denied the Commissioner's petition for review.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a liability which may be converted into life insurance at the option of the insured, but which has not been so converted during the tax year, is one against which a technical insurance reserve, such as is contemplated by Section 245 (a) (2) of the Revenue Act of 1921, may be set up and maintained.

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2. In holding that amounts which had become unconditionally due and payable during the year 1922 to the holders of matured, unsurrendered, and unpaid coupons, and which had been left during said year with respondent to accumulate at interest, and accrued interest thereon, constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

3. In holding that the "legal reserves" required to be maintained by respondent during the year 1922 under the laws of the State of Utah included the amounts, with accrued interest thereon, held by respondent to meet its liabilities during said year to the holders of matured, unsurrendered, and unpaid coupons.

4. In affirming the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The case deals solely with coupons attached to life insurance policies, which had become unconditionally due and payable simultaneously upon the payment of an annual premium by the insured, and which, after their maturity, had been left with the company to accumulate at interest, thereby creating a fund which might be applied to the payment of premiums or withdrawn in cash at any time by the insured. We contend that the Board of Tax Appeals and the Circuit Court of Appeals were in error in holding that the amount of such matured coupons and interest constituted a part of the "reserve funds

required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

A consideration of the decisions of this Court in *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585, *United States* v. *Boston Insurance Co.*, 269 U. S. 197, and *New York Ins. Co.* v. *Edwards*, 271 U. S. 109, shows that the legal reserve for life insurance companies intended by Congress has a special technical meaning, contemplating a fund actuarily computed to meet unmatured life risks on existing policies; that it does not include funds held to satisfy accrued liabilities due to individual policyholders, even though such a fund may be required by State law for solvency purposes. The changes made by Congress in the Revenue Act of 1921 in the method of computation of the gross income and deductions of life insurance companies evidence no purpose to give the term "reserve funds required by law" a new meaning.

The amounts here in controversy are not embraced within the legal reserves forming the basis of the deduction afforded by Section 245 (a) (2) of the Revenue Act of 1921. The matured unpaid coupons involved had not been used to pay insurance premiums or to purchase paid-up additions to the policy. During the taxable year involved they represented an accrued liability of the respondent and a present indebtedness to the individual policyholder, thus differing clearly from the insurance "reserve" held for

the group, which does not become an indebtedness to the individual until the policy matures. The fact that certain options were afforded by which the policyholder might use the coupons and interest in the future to purchase additional insurance benefits does not convert the funds held against the coupon liability into a legal reserve in the taxable year when the options had not been exercised. The legal reserve provides for insurance risks already undertaken and cannot be extended to include insurance which may or may not be purchased in the future. Furthermore, even if these options are exercised, the cash accumulations to the credit of the individual policyholder upon the coupons are sufficient to compensate the company for any additional risk undertaken. Until the policyholder has exercised his option the amount held against matured coupons represents a pure accrued liability, not the subject of the legal reserve. This reserve is computed with reference to a large number of policyholders as a group and cannot include an account of the company with an individual policyholder in which the group does not share.

The adverse decisions of the courts and the Board of Tax Appeals are based upon misconceptions of the character of the reserve required by law and its relation to the amount in issue. The decision of the Court of Claims in *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474, represents the correct view.

ARGUMENT

The instant case deals solely with matured, unsurrendered, and unpaid coupons which by their maturity and the payment of the required premiums on the policies to which they were attached had become unconditionally due and payable on demand by their respective holders. The so-called coupons are not coupons in the sense in which that term is ordinarily used, that is, as representing interest due or to become due on a principal obligation. Instead, each represents a principal amount, paid in as part of the premium required and paid on the due date of the coupon, and immediately due and payable on demand, simultaneously with the payment of the money. They are in effect receipts for money deposited—demand obligations. The amounts represented had been left by the holders with the company to accumulate at compound interest at the rate of 3½%, thereby creating a fund which might be applied to the payment of premiums or withdrawn in cash at any time by the insured (R. 12). The insured was also afforded certain other options with respect to these coupons (R. 11–12), none of which had been exercised or could have been exercised during the taxable year involved. Until one of these options was exercised the money represented by the coupons remained with the company, payable on demand to the insured.

The amounts of the matured coupons thus left to accumulate, and interest thereon, aggregated

$126,949.03 at the beginning, and $146,097.75 at the end of the taxable year. The mean of these two amounts is the sum which the Board of Tax Appeals and the Circuit Court of Appeals held constituted part of the "reserve funds required by law", within the meaning of Section 245 (a) (2) of the Revenue Act of 1921, *infra*, p. 43.[1] We contend that the sum was during the taxable year a matured liability which should not be so included. The position of the court below is in accordance with its own decision in *Commissioner* v. *Great American Life Ins. Co.*, 70 F. (2d) 133, and with the decisions in *Commissioner* v. *Standard Life Ins. Co. of America*, 47 F. (2d) 218 (C. C. A. 3d), and *Commissioner* v. *Western Union Life Ins. Co.*, 61 F. (2d) 207 (C. C. A. 9th). The Board of Tax Appeals has consistently held to the same effect. See *Standard Life Ins. Co. of America* v. *Commissioner*, 13 B. T. A. 13; *Reserve Loan Life Insurance Co.* v. *Commissioner*, 18 B. T. A. 359; *Farmers Life Insurance Co.* v. *Commissioner*, 27 B. T. A. 423; *Missouri State Life Insurance Co.* v. *Commissioner*, 29 B. T. A. 401; *Atlas Life Insurance Co.* v. *Commissioner*, 29 B. T. A. 750. The position of

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[1] A 4% deduction of the mean of the reserve funds was originally diminished by the amount of tax-exempt interest received (R. 5). Subsequently, and following this Court's decision in *Nat'l Life Ins. Co.* v. *United States*, 277 U. S. 508, it was stipulated before the Board of Tax Appeals that the net income should be reduced by the amount of such tax-exempt interest (R. 9–10).

the Government has been sustained in a recent decision of the Court of Claims in *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474, where that court, in an exhaustive opinion, held that the reserve required by law does not include amounts held to meet the obligations on matured unsurrendered coupons.

I

THE TERM "RESERVE FUNDS REQUIRED BY LAW" TO BE MAINTAINED BY A LIFE INSURANCE COMPANY WITHIN THE MEANING OF SECTION 245 (A) (2) OF THE REVENUE ACT OF 1921 AND CORRESPONDING PROVISIONS OF PRIOR REVENUE ACTS, MEANS THAT FUND WHICH, WITH ACCRETIONS FROM INTEREST, IS HELD "RESERVED" TO MATURE OR LIQUIDATE, EITHER BY PAYMENT OR REINSURANCE WITH OTHER COMPANIES, FUTURE UNACCRUED AND CONTINGENT CLAIMS ON EXISTING OBLIGATIONS OF LIFE INSURANCE IN FORCE AND UNMATURED. IT DOES NOT INCLUDE AMOUNTS HELD TO SATISFY ACCRUED LIABILITIES

Under the Revenue Acts prior to the Revenue Act of 1921 insurance companies were entitled to deduct the net addition to reserve funds required by law.[2] The Revenue Act of 1921 inaugurated a new method of taxation with respect to life insurance companies and permitted a deduction of 4% of the mean of the reserve funds required by law and held at the beginning and end of the taxable year. The term "reserve funds required by law" was not defined in any of the various Acts, but the

[2] Act of August 5, 1909, c. 6, 36 Stat. 11, 112, Sec. 38; Act of October 3, 1913, c. 16, 38 Stat. 114, 166, 172, Sec. II G. (b); Revenue Act of 1916, c. 463, 39 Stat. 756, 767–768, Sec. 12 (a) Second; Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077–1079, Sec. 234 (a) (10).

decisions of this Court on the subject show that it has a special technical and peculiar meaning in the law of insurance, and does not include the amounts in controversy here.

The first case to reach this Court on the subject was *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585, involving a deduction claimed for reserves on account of incurred but unpaid policy loss claims of a fire insurance company. The respondent had been required by administrative practice in Pennsylvania to hold assets against such liabilities. In denying the deduction this Court said (p. 589):

> The object is to exercise abundant caution to maintain the companies in a secure financial position.
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> The act of Congress, on the other hand, deals with reserves not particularly in their bearing upon the solvency of the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation. There is a specific provision for deducting "all losses actually sustained within the year and not compensated by insurance or otherwise." And this is a sufficient indication that losses in immediate contemplation, but not as yet actually sustained, were not intended to be treated as part of the reserve funds; that term rather having reference to the funds ordinarily held as against the contingent liability on outstanding policies.

In the foregoing language this Court clearly indicated that *all* reserves required by law were not intended by Congress as deductions; that "the reserve" allowed represents funds held on account of insurance in force and unmatured during the taxable year, as distinguished from those held to meet matured policy obligations. In the *McCoach* case losses actually sustained and paid were allowed under another specific provision of the Act, and this Court held that losses in immediate contemplation but not yet actually paid were not deductible as a part of the legal reserve. In the instant case the only loss actually sustained is represented by interest actually paid, the deduction of which is permitted by Section 245 (a) (8) of the Revenue Act of 1921 (*infra,* p. 43), and has been allowed by the Commissioner (R. 9). At the moment of payment of the premium the obligation of repayment evidenced by the coupon accrued, becoming, in analogy to the *McCoach* case, a loss in immediate contemplation, not yet paid and not deductible as a legal reserve.

The basic requirements of the reserves required by law announced in the *McCoach* case have not been changed in subsequent decisions of this Court. In *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, the Court apparently departed somewhat from the rule of the *McCoach* case and allowed certain sums to be added to reserves on the strength of the requirement of the

State Insurance Department, although they represented accrued claims. Even in that case, however, this Court said (p. 350):

> The term "reserve" or "reserves" has a special meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, variously computed or estimated, which with accretions from interest, is set aside, "reserved," as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims, *and claims accrued, but contingent and indefinite as to amount or time of payment.* (Italics supplied.)

While the italicized portion of this quotation would seem to indicate that accrued claims were to be allowed as a reserve deduction, the next decision of the Court in *United States* v. *Boston Insurance Co.*, 269 U. S. 197, expressly disapproved this departure and reaffirmed the principles of the *McCoach* case. This Court said in part (p. 202):

> It follows from *McCoach* v. *Insurance Co.* that the permitted deductions specified by § 12, Act 1916, do not necessarily include anything which may be denominated "reserve fund" by state statute or officer. We there distinctly ruled that the "reserve fund" of the Federal Act did not include something held by a fire and marine insurance company to cover accrued but unsettled claims for losses. We adhere to and reaffirm that doctrine. How far it must be

> modified, if at all, in respect of insurance companies which issue casualty, surety or liability policies or similar obligations is not now before us.

Referring to the decision in the *Maryland Casualty Co.* case, *supra*, this Court said (p. 203):

> Upon a reexamination of the record it becomes plain that we misapprehended the opinion and ruling of the lower court; also that the reason advanced to support our conclusion is insufficient. * * *. The finding that the Insurance Department of Pennsylvania, pursuant to statute, had at all times since and including 1909 required claimant to keep on hand, as a condition of doing business in the State, "assets as reserves sufficient to cover outstanding losses," without more, was not sufficient to justify the deduction of the reserve as one required by law to be maintained, within the meaning of the Act of Congress. This had been announced by *McCoach* v. *Insurance Co.*

The meaning of the term was next discussed by this Court in *New York Ins. Co.* v. *Edwards*, 271 U. S. 109. There the Superintendent of Insurance of the State of New York required the company to set aside a special fund to meet unreported death losses for amounts due policyholders who had died during the calendar year, and to carry a fund to meet liabilities for the payment of annuities to former soliciting agents as provided by their contracts of employment. The company claimed

the deduction of both of these amounts as net additions to reserve funds required by law. In denying the claim the Court said (pp. 119, 120):

> We think this claim was properly rejected by the Commissioner, although the courts below held otherwise. *McCoach* v. *Insurance Co. of North America,* 244 U. S. 585, and *United States* v. *Boston Insurance Co.,* 269 U. S. 197, pointed out that "the net addition, if any, required by law to be made within the year to reserve funds," does not necessarily include whatever a state official may so designate; that "reserve funds" has a technical meaning. It is unnecessary now to amplify what was there said. The item under consideration represented a liability and not something reserved from premiums to meet policy obligations at maturity.
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> * * * * *
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> As pointed out above, the term "reserve funds," in the taxing Act, has a technical meaning. The compensation which an insurance company agrees to pay soliciting agents has no relation to the reserve held to meet maturing policies; and when it sets aside a fund to provide payments to such agents this cannot be regarded as a reserve within intendment of the statute.

In each of the foregoing cases the taxpayer contended that accrued liabilities constituted "reserves" within the meaning of the Federal statutes. In each case the contention was denied, save only in the *Maryland Casualty Co.* case, *supra,*

which in effect was later disapproved upon the ground that the claims were no longer unaccrued and contingent. So while the company in the *New York Ins. Co.* case was required by the laws of the State of New York to hold "reserves" for future unaccrued and contingent death claims, the so-called "reserves" which the company was required to maintain for accrued but unreported death claims were not "the reserves" required by law within the meaning of the Federal statutes.

The foregoing cases were decided under Acts prior to the Revenue Act of 1921. While Congress adopted a new plan for the taxation of life insurance companies in the latter Act, there is no indication of a purpose to give the term "reserve funds required by law" a new meaning. Under prior Acts the gross income of life insurance companies included their premium receipts and they were permitted to deduct the amounts paid on policies (except as dividends), and amounts required by law to be added to their legal reserves. The inclusion of premium receipts with corresponding deductions was found to be unsatisfactory, and in the Revenue Act of 1921, with the approval of at least most of the life insurance companies, Congress substituted a new basis for computing the tax. See dissenting opinion of Mr. Justice Brandeis in *Nat'l Life Ins. Co.* v. *United States,* 277 U. S. 508, 522–523. It was provided that the gross income should consist of investment income, that is, income from "inter-

ests, dividends, and rents" (Sec. 244 (a), Revenue Act of 1921), and in order to ascertain the net taxable income nine classes of deductions were allowed, one of which is that here in issue, permitted by Section 245 (a) (2), *infra*, p. 43.

Since underwriting income (premium receipts) was not included in gross income, the deduction of the mortality content in the "net or mathematical premium" could no longer be permitted; accordingly the deduction of the net addition to reserves required by law was eliminated. There still remained for consideration, however, the interest content in the "net or mathematical premium", since it was clear that a portion of the interest, dividends and rents received by a life insurance company must be used each year in maintaining the legal reserve, that is, in adding to it on the basis of a certain interest rate, varying from 3% to 4%, according to the requirements of the statutes of the several States. Since gross income included all interest, dividends and rents received, it was proper to permit the deduction of that portion thereof included in the gross income which was required to mature the policy as a life risk, namely, the interest element. Accordingly Congress provided for the deduction of 4 per centum of the mean of the reserve (the highest percent required to be credited thereto by any of the State laws), and based the deduction upon the mean of the reserves held at the beginning and end of the taxable year.

The deduction allowed by Section 245 (a) (2) of the Revenue Act of 1921 was perfectly consistent with that permitted by prior Acts, to wit, the net addition to reserves required by law, and under the new Act no different meaning is to be attributed to the term "reserve funds." See *Massachusetts Mut. Life Ins. Co.* v. *United States,* 56 F. (2d) 897 (C. Cls.); *Standard Life Insurance Co. of America* v. *Commissioner,* 13 B. T. A. 13, 27. We submit that the term as it is used in the Revenue Act of 1921 does not embrace everything required as a reserve by State statute or State official; that its special meaning for life insurance purposes contemplates a fund actuarily computed, set aside from premiums, and built up with accretions from interest to meet unmatured life risks upon existing policies; and that it does not include funds held to satisfy matured accrued liabilities due to individual policyholders. Any such fund, although it may be required by State law, is merely a solvency reserve, and not the special technical reserve peculiar to insurance contracts contemplated by the Act. The reserve required by law is not a present liability. *Duffy* v. *Mutual Benefit Co.,* 272 U. S. 613. The special meaning of the legal reserve excludes amounts held on account of matured obligations and also those held by insurance companies which do not represent insurance in existence and in force during the taxable year. In the one case the reserve has already served its purpose and the amounts

held have become accrued liabilities, unconditionally due and payable; in the other, since there is no insurance as yet in existence, there can be no reserve of the character contemplated by the Act.

II

THE AMOUNT IN CONTROVERSY IN THE PRESENT CASE IS NOT ALLOWABLE AS A DEDUCTION UNDER SECTION 245 (a) (2) OF THE REVENUE ACT OF 1921

It is conceded that assets equal to the amounts in issue were required by the State law to be held by the company. Under the Utah statute (Revised Statutes, 1933, Title 43, c. 3, Sec. 4, *infra*, p. 45), the respondent was required to maintain assets equal to or exceeding all of its "outstanding liabilities", including "legal reserves", as provided in Section 12 of Title 43, c. 3, of the Utah Revised Statutes, *infra* p. 46. Consequently the respondent was required to have on hand not only the legal reserves peculiar to life insurance contracts calculated upon the basis of the American Experience Table of Mortality, with interest at 3½% per annum, but in addition thereto, assets in an amount equal to all of its outstanding liabilities, including the amount of the matured unpaid coupons here in issue, together with accrued interest thereon. The question, however, is not whether respondent was required under the law of the State to maintain assets equal to all of its liabilities, but whether the amount here involved constituted a legal reserve within the meaning of the Federal statute. We contend that it did not.

The correct answer to the question would seem to depend upon whether the coupons in this case involved life insurance during the taxable year. If they did not, then there is no insurance liability with respect to these coupons against which the insurance reserve is required to be maintained. It is not disputed that the amounts in controversy are represented by unpaid matured coupons which have been left with the company to accumulate at interest (R. 9). They had not been used to pay insurance premiums. If they had been so used this case would not be here. Also they had not been used, nor could they be used, to purchase paid-up life additions to the policy (R. 9, 14), since the terms of the policy provide that the election must have been made within one month after the due date of the second annual premium (R. 14); in any event, any such coupon so used must have been surrendered to the company within one month of its due date (R. 14), and such coupon would not be here in issue. Since none of the options mentioned had been exercised, the matured coupons, together with interest, constituted by the express terms of the policy a fund to the credit of the policyholder which might be withdrawn in cash at any time (R. 9, 12), or which, if not withdrawn, upon the death of the insured would be payable to th beneficiary in cash in addition to the face amount of the policy (R. 9). Upon default in payment of premiums the amount was payable to the

insured in addition to the rights granted with respect to his insurance (R. 14).

The coupons thus represented, during the year 1922, a pure liability of the respondent. The policyholder's election to leave them with the company at the time they became due and payable does not change their character as liabilities of the company, inasmuch as they are subject to his right to demand payment at any time. They evidence a pure debtor and creditor relationship. They are as much a direct liability to the policyholder as a deposit in a bank. They represent a present indebtedness to the *individual* policyholder, and thus differ clearly from the insurance "reserve" held for the group, which does not become an indebtedness to the individual until the policy matures. *Duffy* v. *Mutual Benefit Co.*, 272 U. S. 613, 618–619.

The fact that certain options were afforded by which the policyholder might in the future use his accrued matured coupons and interest as cash for the purchase of additional insurance benefits does not serve to convert the funds held to meet the accrued coupon obligations into an insurance reserve for the year 1922 when the options had not been exercised. One of these options permits the amount of each of the nineteen coupons as it matures to be left with the company to accumulate at interest and to be surrendered together with the policy at the end of twenty years, in which event the policyholder may elect to receive one of the

following: (1) A cash payment of $8,000; (2) a paid-up policy for life of $14,130, subject to satisfactory evidence of insurability for the excess over the original face amount of the policy; (3) a guaranteed annual income of $490 for at least 20 years; (4) a paid-up policy for life of $10,000, without medical re-examination, and an annuity of $174.40 (R. 11). The remaining option provides that if all of the values represented by the first fourteen coupons are left on deposit with the company at interest, the company will, upon written request of the insured, issue a full paid-up policy for $10,000 at the end of 15 years upon surrender of the policy and all of the coupons originally attached (R. 12).

None of the above options was exercised, nor could any have been exercised, during the year 1922 to convert the matured unpaid coupons then payable on demand into amounts then held at life risk, that is, into life insurance. The respondent was not organized until 1911 and accordingly none of the above options to convert accrued liability into an insurance risk could have been exercised until 1926, fifteen years later.

Moreover, whether or not the conversion could have taken place in the year 1922, the fact remains that it had not occurred and no insurance liability existed upon the respondent's part save the obligation to pay the face amount of the policy, the reserves for which are not in dispute in this case.

The fact that the coupons might be used in the future to acquire additional insurance benefits is immaterial. The Revenue Acts generally are concerned with certainties, not conjectures. So in *Brown* v. *Helvering,* 291 U. S. 193, the taxpayer was not allowed to set up a reserve to meet cancellations which might reasonably be expected to occur in the future. Here a reserve allowed to provide for insurance risks already undertaken may not be extended to include insurance which may or may not be purchased in the future. It would be just as logical to permit the respondent to establish, as part of its legal reserve, funds set aside in anticipation of a possibility that some or all of its policyholders might later pay in additional amounts, either to increase the amount of their insurance or to shorten the premium-paying period. The income of the company for the year 1922 must be taxable then or not at all. It cannot be reduced by a deduction given for a specific purpose when the purpose itself is absent and may never come into existence.

Furthermore, none of the possibilities presented in the options referred to will increase the insurance risk beyond the face amount of the policy or principal amount insured until actually exercised, in which event the cash accumulations to the credit of the individual policyholder are sufficient to compensate the company for any additional risk undertaken. For example, where the policyholder allows his coupons to mature and remain at inter-

est until all premiums are paid, he may, if then insurable, receive a paid-up policy for the sum of $14,130. This amount exactly equals the face value of the policy plus the amount of insurance which may be purchased at age 55 by a net single premium of $2,340, the face value of the matured coupons with interest at the end of 20 years.[3] Similarly, the sum of $8,000 payable in cash at the end of 20 years upon surrender of the policy and the coupons equals $5,660, the cash or loan value of the policy at that time (R. 15), plus the value of the coupons with interest.

A similar situation obtains with respect to the right of the policyholder at the end of the fifteenth policy year to surrender his policy and all coupons originally attached thereto, including the value of the first fourteen coupons with accrued interest thereon, and in lieu thereof to receive a fully paid-up policy for $10,000—in other words, to apply his matured unpaid coupons with accrued interest thereon to convert his 19-payment life policy into a 14-payment life policy at the end of the fifteenth policy year. (See "Fully paid-up benefit", R. 12.) The "reserve" on a 19-payment life policy at the end of the fourteenth year (here the fifteenth policy year, since the first year is preliminary term insurance) is actually $377 per

[3] This statement may be verified by reference to the American Experience Table of Mortality, with interest at 3½%. See Willey, Principles and Practice of Life Insurance, Eighth Edition, p. 226.

thousand (R. 15). The aggregate value of the first fourteen coupons with accrued interest thereon is $153.78 per thousand, and the sum of the two, $530.78 per thousand. The net single premium at age 50 or the attained age at the end of the fifteenth policy year is but $508.49 per thousand.[4] Thus the actual cash or surrender value of the policy at the end of the fifteenth policy year plus the accumulated value of the fourteen matured and unsurrendered coupons with accrued interest thereon exceeds the net single premium on a $1,000 policy at age 50 by $22.29.

It has been contended that the presence of these coupons automatically converts the so-called 20-payment life policy from the date of issuance into a defeasible so-called 15-payment life policy. The provisions of the policy, however, negative this contention, since it is therein provided (R. 12) that upon the death of the insured before the actual conversion of the policy at the end of the fifteenth policy year the face of the policy plus the value of the matured coupons with accrued interest will be paid to the beneficiary. Obviously only the face of the policy would be payable if the conversion had actually occurred. Moreover, the table of cash or loan values attached to the policy (R. 15) shows that the reserve actually carried is that required on a 19-payment life policy.

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[4] See Willey, Principles and Practice of Life Insurance, Eighth Edition, p. 222.

From the foregoing examples it is apparent that the liability of the company is not increased beyond the face amount of the policy unless and until an option is exercised to purchase additional insurance or an annuity, in either of which events the holder of the coupons is in precisely the same situation as any other purchaser of insurance or of an annuity at age 55 who has available funds equal to the matured coupons with accrued interest. So also with respect to the option to reduce the premium-paying period. The liability of the company with respect to the face amount of the policy is not increased, and any individual with the requisite amount of cash would be permitted to convert a so-called 20-payment life policy into a so-called 15-payment life policy. The greatest possible liability of the insurer is no larger than it would be with respect to any person able and willing to devote the amount of cash represented by the coupons to an insurance contract.

It is unimportant, so far as the statutory intendment of reserve funds is concerned, that the excess payment of each year's premium over the amount required to carry the outstanding insurance is sufficient when added to what is already in reserve to purchase insurance on some other plan. Until the policyholder has exercised his option the amount held against the coupons represents no more than deposits at interest, and constitutes a pure liability. We submit that any

so-called reserve against such a liability is not an insurance reserve within the purview of the statute.

A further argument in support of our contention rests upon the very nature of the insurance reserve, which demonstrates that it can never apply to accrued liabilities due to individual policyholders in advance of their use for insurance purposes. The insurance reserve has reference to a large number of policyholders as a whole or group, and not to an individual policyholder. By the reserve funds set up the company is always in funds with which to meet an individual policy claim, irrespective of the time such individual policy may have been in force. To insure a single life within a given period is a gamble because the individual must either die or survive that period, with the result that there is either a great loss or gain. When a great number of lives are combined in the same group, the fluctuations in the rate of deaths from year to year will vary by only the smallest fraction of 1 per cent. Hence by means of the group, uncertainty of life is converted into certainty of death claims. Experience has shown that among a large group deaths will occur in accordance with a certain table of mortality. The "Experience Table" represents averages which can be relied upon. Therefore the "legal reserve" can never be based upon the company's account with an individual in which the group can never, directly or indirectly, par-

ticipate. Once a liability arises to an individual, as in the case of a policy loss claim, the amount ceases to be a part of the insurance reserve. It becomes a pure liability account with the individual.

The coupon credits here likewise are liabilities to individuals, having no reference to the group. To include them in the reserve for the group violates the basic principle upon which the insurance reserve is founded. If a sufficient number of persons is insured under all policies and at all different ages to insure the operation of the law of averages, the reserve so determined will be adequate for any policy. But there is nothing upon which the law of averages can operate until the matured coupon credits have been used to put life insurance in force. Until so used, they are merely accrued liabilities.

The language of the Court of Claims in *Continental Assur. Co.* v. *United States, supra,* is particularly apposite here. The court said in part (p. 482):

> The business, however, is based upon the law of averages for the group insured and for this reason the liability on the policy of life insurance prior to its maturity is not absolute but contingent. Therefore reserves, actuarily determined, must be set up out of premiums when paid to meet future unaccrued and contingent policy obligations at maturity. It was the "net value re-

serve,'" "something reserved from premiums to meet policy obligations at maturity" to which the Supreme Court referred in *New York Life Ins. Co.* v. *Edwards, supra,* and the Court held that the amounts there claimed were not reserves required by law within the meaning of the federal statutes because the liability of the company in that case was an accrued and absolute liability.

III

THE ADVERSE DECISIONS OF THE COURTS AND THE BOARD OF TAX APPEALS ARE BASED UPON MISCONCEPTIONS OF THE CHARACTER OF THE RESERVE REQUIRED BY LAW AND ITS RELATION TO THE AMOUNT IN ISSUE

The decision of the court below is based upon its prior decision in *Commissioner* v. *Great American Life Ins. Co.,* 70 F. (2d) 133, and it is necessary to look to the latter case to determine the basis of the court's holding that the amounts of matured unpaid coupons constitute reserves required by law within the meaning of the Act. In the *Great American Life Ins. Co.* case the court conceded that in using the word "reserve" Congress had in mind the technical insurance reserve, and that the company might not deduct a reserve which does not come within the technical meaning merely because it was required to be maintained by State authority. Its decision seems to be based upon the ground that the technical reserve is one held as against a contingent liability on outstanding policies; that the coupon liabilities meet the test since the time when they will be demanded in cash is de-

pendent upon the will of the insured, and also since they may later be converted into additional insurance benefits. From these facts the conclusion is drawn that the liability is contingent as to time and manner of payment.

The court has failed to note the real and important distinction between the technical reserve and the matured coupon liabilities. The technical reserve is based upon outstanding policies involving life risks, since it is only maintained in connection with all members of the group insured. The funds necessary to pay the face amount of the life policy in a particular case are not withdrawn solely from the premiums paid by the insured upon that policy, but from the aggregate funds contributed through premiums of the group. The contingent liability before maturity is accordingly general and not specific.

On the other hand, the funds necessary to pay the face amount of the matured coupons plus interest are made up solely from the excess premiums paid in by the individual, in which the other members of the group have no share, and with which the computation of the aggregate or group liability has no concern. Until the excess premiums represented by the coupons are converted into insurance involving the element of life risk, they are not properly a part of the group reserve. When and if they are so converted, they immediately become a part of the technical reserve upon which the deduction will be allowed. The fact that the time when the accrued

liability may be demanded is subject to the policyholder's will does not convert the individual liability into a group reserve.

The foregoing also illustrates the fact that the court was in error in likening the coupons to the cash surrender value of a policy. The amount of the obligation which the company will repay upon surrender of the policy is that portion of the group reserve which will be repaid and which is no longer necessary as a reserve if the existing life risk is cancelled. In order to obtain this amount it is necessary to surrender the policy and eliminate the face amount as a death benefit. But when the coupons are surrendered and cashed the face amount of the policy is not affected. It remains in existence as a life risk of the company for which a technical reserve must be maintained.

In holding that an accrued liability, the matured coupons, contingent as to time and method of payment, is embraced within the technical reserve, the court has, in effect, adopted that part of the definition used in *Maryland Casualty Co.* v. *United States, supra* (p. 350), which states that the reserve includes a fund set aside to liquidate "claims accrued, but contingent and indefinite as to amount or time of payment." As we have contended heretofore, that portion of this definition is contrary to the principles of *McCoach* v. *Insurance Co. of N. Amer., supra,* and was disapproved in *United States* v. *Boston Insurance Co., supra.*

It also appears that the court was greatly influenced by the statement made by this Court in *Williams* v. *Union Central Co.*, 291 U. S. 170, in which, speaking of guaranteed "premium reduction coupons" involved in the case of *Great Southern Life Ins. Co.* v. *Jones*, 35 F. (2d) 122 (C. C. A. 8th), this Court said (p. 182) that they were "fixed liabilities requiring a reserve." But neither case involved the question as to what constituted a *legal reserve* within the meaning of the taxing Acts. The sole point presented was whether an insurance company is bound to use any funds in its hands due the insured to avoid a forfeiture for nonpayment of premiums, the answer to which depends largely upon the provisions of the particular policy. We submit that the language used in the *Union Central* case gives no indication that this Court was concerned with a technical legal reserve, and that it cannot be considered authority for the proposition that accrued liabilities upon the coupons constitute a part of such reserve.

In *Commissioner* v. *Great American Life Ins. Co., supra*, the court also thought that the failure to amend the statute furnished strong evidence that the Board of Tax Appeals and the courts had correctly divined the legislative intent as to the meaning of "reserve funds required by law." But the fact that certain decisions have construed the deduction to include the amounts here involved does not demonstrate that this was the legislative intent. The Commissioner has not acquiesced in,

and has continued to oppose, this construction. The first of the decisions, that of the Board of Tax Appeals in *Standard Life Insurance Co. of America* v. *Commissioner, supra,* was promulgated in 1928. In 1926, after the decisions of this Court in *United States* v. *Boston Insurance Co., supra,* and *New York Ins. Co.* v. *Edwards, supra,* the Bureau issued a ruling specifically holding that coupons left with an insurance company and accrued interest thereon are not to be included in the reserves under Section 245 (a) (2) of the Revenue Act of 1921. S. R. 9610, V-2 Cumulative Bulletin 189. This has never been revoked, and it still represents the administrative position.

Finally, the necessity for maintaining reserves for matured coupons on the ground of solvency, stressed by the court in the *Great American Life Ins. Co.* case, *supra,* is beside the point. That such a requirement does not furnish the test for the legal reserve is answered by the language of this Court in *McCoach* v. *Insurance Co. of N. Amer., supra* (p. 589) that—

> The act of Congress, on the other hand, deals with reserves not particularly in their bearing upon the solvency of the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation.

Similarly, the fact that the company must set aside amounts from its investment income to meet the interest accruing on matured coupons is not

sufficient to justify the deduction as a reserve. For purposes of solvency it may likewise set aside from income amounts necessary to satisfy other accrued unpaid obligations. But this does not mean that the amounts necessary to meet such liabilities are part of the technical reserve contemplated by the statute.

The only other adverse decision in which any extended discussion of the principle occurred is that of the Board of Tax Appeals in *Standard Life Insurance Co. of America* v. *Commissioner, supra.* The decisions of the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Standard Life Ins. Co. of America,* 47 F. (2d) 218, and the Circuit Court of Appeals for the Ninth Circuit in *Commissioner* v. *Western Union Life Ins. Co.,* 61 F. (2d) 207, are based upon that of the Board in the *Standard Life Insurance Co. of America* case. The only additional reasoning in the *Western Union Life Ins. Co.* case is based upon the assumption that the coupon liabilities come within that part of the definition of a reserve contained in the *Maryland Casualty Co.* case (p. 350), but subsequently disapproved in *United States* v. *Boston Insurance Co., supra,* namely, "claims accrued, but contingent and indefinite as to amount or time of payment."

The Board's decision in the *Standard Life Insurance Co. of America* case is based upon certain assumptions which we contend are erroneous. The Board stated that the definition of reserves in the

McCoach case as funds held against the contingent liability on outstanding policies does not apply to life-insurance companies, since the life-insurance company has an absolute and uncontingent liability in respect of every policy; that the liability upon unsurrendered coupons is likewise absolute and the same as the liability to pay any portion of the principal of the policy; that if the company pays the face amount of the coupons it is simply paying a policy obligation and the insured has surrendered part of the policy; consequently, a reserve to meet the coupons is something reserved from premiums to meet policy obligations at maturity, within the language used by this Court in *New York Ins. Co.* v. *Edwards, supra,* p. 119.

The fundamental error in the Board's reasoning lies in the assumption that a life-insurance company has an absolute liability in respect of every policy so long as premiums are paid thereon, and that such liability is not contingent. We have already pointed out that it is only upon the maturity of a policy that a policyholder becomes a creditor of the company; then, for the first time, there is an indebtedness (*Duffy* v. *Mutual Benefit Co., supra,* p. 618). If the life insurance company's liability is contingent and not absolute on its life contracts, then reserves are required. If the company's liability were absolute to the individual policyholder, as the Board decides, there would be no need for the use of mortality tables. Since the business of life insurance is based upon the law of

averages for the group insured, the liability on a policy of life insurance prior to its maturity is not absolute but contingent. Accordingly, reserves actuarily determined must be set up out of premiums when paid to meet future unaccrued and contingent policy obligations at maturity. It was the net value reserve, "something reserved from premiums to meet policy obligations at maturity", to which this Court referred in the *New York Ins. Co.* case, *supra,* and it was because the liability of the company in that case for death losses, which had occurred but were unreported, was an accrued and absolute liability that the amounts there claimed as reserves were held not to constitute "reserves" required by law within the meaning of the Federal statutes.

Another erroneous premise of the Board is that the company is simply paying off a policy obligation and that the policyholder has surrendered a part of his policy when a matured coupon is paid with interest. Clearly the policyholder, by demanding and accepting the amount due him on his matured coupons with interest, does not surrender any part of his life-insurance policy, nor is the company's net value reserve held against its life-insurance obligations at maturity thereby affected in the slightest degree. The fact is that the company by the payment of a matured coupon with interest discharges to that extent a pure liability which had accrued on the coupon contract, and which had never represented life insurance in

force. It still remains bound to the insured to the fullest extent of its life-insurance policy obligation, against which it was required to maintain the legal reserve.

In subsequent decisions the Board has held that dividends of a mutual company left with the company are not reserves required by law. See *Midland Mutual Life Insurance Co.* v. *Commissioner,* 19 B. T. A. 765. The Court of Claims has held to the same effect. *Minnesota Mutual Life Ins. Co.* v. *United States,* 66 C. Cls. 481, certiorari denied, 279 U. S. 856; *Massachusetts Mut. Life Ins. Co.* v. *United States,* 56 F.(2d) 897. It has also been held that the interest upon such dividends, when paid, is deductible as interest under Section 245 (a) (8) of the Revenue Act of 1926 (c. 27, 44 Stat. 9, U. S. C. App., Title 26, Sec. 1004), just as the interest was allowed in this case. See *Massachusetts Mut. Life Ins. Co.* v. *United States,* 59 F.(2d) 116 (C. Cls.), affirmed by this Court, 288 U. S. 269. There is no real distinction in principle, insofar as the reserve question is concerned, between such a dividend and a coupon of the type here involved. Each becomes an accrued liability, the dividend upon its declaration, the coupon upon its maturity and the payment of the requisite premium. Thenceforth each is an accrued liability of the company, and not a life risk requiring the insurance reserve, unless and until it is converted into some form of insurance at life risk requiring a group reserve. We contend that the decisions

in the cases just cited represent the correct view and that the same principle should apply to matured coupon liabilities.

We submit that the conclusions of the Court of Claims recited in its opinion in *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474, 483–484, are correct and dispose of the controversy here, namely:

> (1) That accrued liabilities are not the subject of the "reserve fund" deductions granted by Congress in any of the revenue acts; (2) that the "reserve" contemplated in the Federal statutes is "that fund which when added to the present value of future net premiums is equal to the present value of future death claims"; that is, the mathematical equivalent of the obligation incurred by the company to pay the sum insured at the death of the policyholder or upon the surrender and cancellation of the policy; (3) that the "reserve" contemplated in the federal statutes is calculated upon the basis of a selected table of mortality plus an assumed rate of interest; and that reserves not so calculated, whether required by state law or by state officer, are not "reserve funds required by law" within the meaning of the federal statutes; and (4) that the "reserve fund" required by law within the meaning of the federal statutes does not include "solvency" reserves required to be maintained by state law or a state officer to keep the company in sound financial condition.

CONCLUSION

It is respectfully submitted that the decision of the court below is erroneous and should be reversed.

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JANUARY 1935.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 261:

SEC. 245. (a) That in the case of a life-insurance company the term "net income" means the gross income less—

* * * * *

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life-insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * *

Treasury Regulations 62, promulgated under the Revenue Act of 1921:

> ART. 681. *Reserve funds.*—Under paragraphs (1) and (2) of section 245 (a), life insurance companies are entitled to deduct from gross income: (1) Interest which is exempted in the case of other taxpayers by section 213 (b) (4) and articles 74–83; and (2) the excess, if any, of the reserve deduction specified in section 245 (a) (2) over the amount of such interest. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance. In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Only reserves peculiar to insurance companies are to be taken into consideration. Reserves "maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage" (*Maryland Casualty Co.* v. *United States,* 251 U. S. 342),

will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7, 8, 9, 10, and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19, and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held.

Revised Statutes of Utah, 1933, Title 43:

CHAPTER 3

* * * * *

SEC. 4. *Capital to be full-paid and unimpaired.*—No stock company shall do any [life] insurance business in this state before its capital is fully paid up. Said capital must be unimpaired, that is, the assets of such company must equal or exceed all liabilities for losses reported, expenses, taxes and other outstanding *liabilities,* including *the legal reserves* as provided in sections 43–3–12 * * * (L. 21, p. 96, § 1144 [8]). (Italics supplied.)

* * * * *

SEC. 12. *Life insurance—Valuation of policies and reserves.*—For the purpose of making valuations of life insurance policies and of determining the reserves required to be maintained therefor under the provisions of this title *the rate of interest assumed* shall be 3½ percent per annum, and the rate of mortality shall be established by the table known as the "American Experience Table of Mortality" for policies issued after January 1, 1910; * * * (C. L. 17, § 1153). (Italics supplied.)

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In the Supreme Court of the United States.

OCTOBER TERM, 1934

No. 537

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

INTER-MOUNTAIN LIFE INSURANCE COMPANY.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION

OPINION BELOW

The Board of Tax Appeals rendered no formal opinion, but on the facts as stipulated (R. 10-29) held that the reserves here in question were reserves required by law within the meaning of the tax act. (R. 30.) The opinion of the Circuit Court of Appeals for the Tenth Circuit is reported in 71 Fed. (2d) 962.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 25, 1934 (R. 41). On motion of petitioner the time within which to file petition for writ of certiorari was extended sixty days. (R. 42.) The jurisdiction of this Court depends upon Section 240 (a) of the Judicial Code, as amended by the act of February 13, 1925.

QUESTION PRESENTED

Are reserves required by law to be maintained on account of portions of the valuation of coupon life insurance policies, being represented by such coupons, reserves required by law within the meaning of the 1921 Tax Act.

STATUTE AND REGULATIONS INVOLVED

Section 245 (a) (2) of c. 136, 42 Stat. 227, 261, and Article 681 of Treasury Regulations 62, as quoted in the Appendix to the petition at pages 11-13.

STATEMENT

The facts material to the present question, as shown by the stipulation of facts (R. 10-29), briefly stated, are as follows:

Respondent made and sold level premium 20-Payment Life Coupon Policies—Non-Participating, during the year 1922 and prior in the states of Utah, Idaho and Arizona (R. 11, 14). These policies contained the following provisions:

If all the premiums on the policy are paid in cash when due and at the end of twenty years the policy and all coupons attached thereto are delivered to the company, it will merge into a full paid life policy for $14,130.00, subject to satisfactory evidence of the insurability of the insured at that time (Guaranteed Option 2); or, without medical re-examination, into a full paid life policy for $10,000.00, with an annuity of $174.40 for the life of the insured (Guaranteed Option 4); or a full paid contract for an annuity of $490.00 for at least twenty years, and as long thereafter as the insured may survive (Guaranteed Option 3); or, at the insured's option, the company will pay him $8,000.00 (Guaranteed Option 1) (R. 15). Further, if all premiums are paid in cash when due and no matured coupons have been previously surrendered to the company, at the end of fifteen years, the policy

will merge into a full paid life policy for $10,000.00 (R. 16). The policy carried nineteen coupons, maturing on the respective anniversaries of the policy (R. 21-22). Matured coupons could be surrendered for paid up additions to the policy, reconvertible at any time into the cash value thereof (R. 22).

On January 1, 1922, the reserve maintained by respondent on account of its policy obligations represented by unsurrendered matured coupons was $126,949.03, and on December 31st of that year $146,097.75 (R. 12). Four per cent (4%) of the mean thereof amounted to $5,460.94. The Commissioner did not allow this amount as a deduction from gross income, but in lieu thereof allowed interest paid on coupons surrendered during the year amounting to $897.58 (R. 13).

ARGUMENT

From the above statement it will be seen that if respondent is entitled to the reserve deduction of $5,460.94, it is not entitled to the interest deduction of $897.58, as allowed by the Commissioner. Thus the amount of tax involved herein is the tax at the 1922 rate of 12½% on the difference between these amounts, or $570.42.

In *Continental Assurance Company* v. *United States*, referred to in the petition, the Court of Claims states that the amount of tax involved on the question at issue here was $698.81.

From the amounts involved in these two cases it can be seen that the question here at issue is comparatively insignificant and inconsequential and, therefore, is of no great public interest or concern.

The petition alleges a conflict in the decisions of these two cases, but when the contract at issue here is analyzed and compared with the court's analysis of the insurance contracts in the *Continental* case, on account of the differences in these contracts, no par-

ticular conflict is apparent. Consequently, considering the analysis of the insurance contracts in these cases by the lower courts, it is entirely probable that the two decisions will stand side by side in complete harmony and consistency.

The statutes of Utah, Idaho and Arizona, where the respondent was transacting business during the year 1922, provided for the annual valuation of all outstanding life policies by the insurance authorities thereof and the maintenance of a net value reserve equal to such valuation, which formed the reinsurance basis for such policies.

In *Great Southern Life Insurance Company* v. *Jones*, 35 Fed. (2d) 122, the Circuit Court of Appeals held:

> "But as only one premium was charged as a consideration for all the obligations assumed by the insurer, we think the policy constitutes but one agreement and must be considered as a whole."

This is a familiar rule applicable to the computation of net value reserves for the largest insurance liability assumed by the contract. This was recognized in *Standard Life Insurance Co. of America* v. *Commissioner*, 13 B. T. A. 13, 29, where it is held that:

> "It is further submitted that, where a variety of options is granted the policyholder, the contingency which would be the most costly to the company is the obligation which should determine the proper reserve."

Consequently, here, the net value reserve must be determined for a full paid policy at the end of twenty years in the amount of $14,130.00, if at that time the insured possesses a satisfactory degree of insurability, or, if not, in lieu thereof, without medical examination, a full paid policy for $10,000.00, with an annuity of $174.40 for the life of the insured. Certainly it must be admitted that in arriving at such results, under

the terms of the original policy, the value of the matured coupons attached thereto must have received full consideration. Therefore, it is submitted that the entire reserve maintained for such a policy must have been the usual net value reserve, paid for basis, as mathematically and actuarially computed. In this view of the case, the coupons seem to constitute a clever and ingenious device which enabled the insured to withdraw from the entire reserve maintained for the policy as a whole the surrender value of matured coupons whenever his necessities might require without in any manner impairing the remainder of his insurance benefits under the policy. This may explain why some companies previously included the entire reserve for their coupon policies in the net value reserve, paid for basis, while others reported the portion of their reserves relating to coupon values elsewhere in the liability schedule of their annual statements.

In this connection, it is interesting to note that the opinion of the Board of Tax Appeals in *Standard Life Insurance Co. of America, supra* (at page 26) quotes a resolution adopted by the National Convention of Insurance Commissioners in 1927, regarding the reporting of the reserve for coupon life policies, as follows:

> "There has been some lack of uniformity among some companies which write so-called 'coupon policies' in the manner of reporting matured coupons which are not cashed by the policyholder as they become due but are permitted to accumulate and remain with the company to apply to the reduction of the premium paying period, the purchase of additional insurance, or some similar guaranteed policy benefit. The proceeds of such matured coupons are, clearly, held by such companies to meet guaranteed policy obligations at maturity. They are therefore reserves required by law and should be included in the reserves of the company reported above Line Seven on the Convention blank."

This resolution shows that the opinion of the insurance authorities of the various states is that reserves for these coupon life policies are a part of the net value reserve, paid for basis.

Since the decision of the Board of Tax Appeals in the *Standard Life case supra,* affirmed by the Circuit Court of Appeals in 47 Fed. (2d) 218, Congress has had the revenue laws of 1932 and 1934 under consideration and has made no change in the basis for the deduction from gross income on account of reserve funds, although in the 1934 Act it did provide that in certain cases the rate for the computation of such deduction should be reduced. Therefore, it must be assumed that Congress thereby accepted and ratified the decision of the Board of Tax Appeals, as affirmed in *Commissioner* v. *Standard Life Insurance Co. of America, supra,* and the subsequent court decisions prior to the 1934 Revenue Act, as to the reserves to be used as the basis for the computation of this reserve deduction.

The court's attention is especially invited to the cases of *Commissioner* v. *Standard Life Insurance Company of America, supra; Commissioner* v. *Western Union Life Insurance Company,* 61 Fed. (2d) 207, *Commissioner* v. *Great American Life Insurance Company,* 70 Fed. (2d) 133, including the action of the court in denying petitioner's motion for rehearing, in the consideration of the petition herein.

CONCLUSION

In consideration of the foregoing, it is respectfully submitted that the petition herein should be denied.

Respectfully submitted,

STEPHEN W. DOWNEY,
Attorney for Respondent.

A. R. Serven,
Of Counsel.

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 537

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

INTER-MOUNTAIN LIFE INSURANCE COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF FOR RESPONDENT

OPINION BELOW

The Board of Tax Appeals rendered no formal opinion, but on the facts as stipulated (R. 8-19) held that the reserves here in question were reserves required by law within the meaning of the tax act (R. 19). The opinion of the Circuit Court of Appeals for the Tenth Circuit is reported in 71 Fed. (2d) 962.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 25, 1934 (R. 26). The jurisdiction of this Court depends upon Section 240 (a) of the Judicial Code, as amended by the act of February 13, 1925.

QUESTION PRESENTED

Are reserves required by law to be maintained on account of portions of the valuation of coupon life insurance policies, being represented by such coupons, reserves required by law within the meaning of the 1921 tax act.

STATUTES AND REGULATIONS INVOLVED

Section 245 (a) (2) of c. 136, 42 Stat. 227, 261, and Article 681 of Treasury Regulations 62, as quoted in the Appendix to Petitioner's brief at pages 43-45; Sections 4, 12, Ch. 3, T. 43, Revised Statutes Utah, 1933.

STATEMENT

The facts material to the present question, as shown by the stipulation of facts (R. 8-19), briefly stated, are as follows:

Respondent a capital stock life insurance company, organized in 1911, under the laws of the state of Utah, made and sold level premium 20-Payment Life Coupon Policies—Non-Participating, during the year 1922 and prior in the states of Utah, Idaho and Arizona (R. 8). These policies contained the following provisions:

If all the premiums on the policy are paid in cash when due and at the end of twenty years the policy and all coupons attached thereto are delivered to the

company, it will merge into a full paid life policy for $14,130.00, subject to satisfactory evidence of the insurability of the insured at that time (Guaranteed Option 2); or, without medical re-examination, into a full paid life policy for $10,000.00, with an annuity of $174.40 for the life of the insured (Guaranteed Option 4); or a full paid contract for an annuity of $490.00 for at least twenty years, and as long thereafter as the insured may survive (Guaranteed Option 3); or, at the insured's option, the company will pay him $8,000.00 (Guaranteed Option 1) (R. 11). Further, if all premiums are paid in cash when due and no matured coupons have been previously surrendered to the company, at the end of fifteen years the policy will merge into a full paid life policy for $10,000.00 (R. 12). The policy carried nineteen coupons, maturing on the respective anniversaries of the policy and matured coupons could be surrendered for paid up additions to the policy, reconvertible at any time into the cash value thereof (R. 14-15).

On January 1, 1922, the reserve maintained by respondent on account of its policy obligations represented by unsurrendered matured coupons was $126,949.03, and on December 31st of that year $146,097.75 (R. 9). Four per cent (4%) of the mean thereof amounted to $5,460.94. The Commissioner did not allow this amount as a deduction from gross income, but in lieu thereof allowed interest paid on coupons surrendered during the year amounting to $897.58 (R. 9-10).

SUMMARY OF ARGUMENT

Reserve funds required by law defined. Valuations by heads of State Insurance Departments constitute the legal reserves required by law therefor.

Insurance rights and obligations under specimen policy.

Reserve at end of twenty years with which to purchase the paid up insurance contract under Options 2, 3 and 4 amounts to $8,000.000. The accumulated reserve for the specimen policy, exclusive of coupon values, at end of twenty years amounts to $5,660.00. The remainder of the $8,000.00 reserve consists of the accumulated reserve for the coupon values. The coupon values represent parts of the reserve required by law for the specimen policy. The coupons enable the insured to surrender portions of his insurance protection, if desired, while retaining the remainder thereof. Hence the reserve for such policy is usually carried, as a matter of convenience, in two accounts or sections, one including the reserve in connection with the coupon values, which may be surrendered for the cash surrender value thereof, and the other the reserve for the remainder of the policy, the cash surrender for which can only be secured by the surrender of all then existing insurance rights under the policy. The accrued liability for such coupons does not attach until they are actually surrendered for the cash value thereof.

As the heads of the various State Insurance Departments, who make the valuations of the outstanding policies which by law constitute the reserves therefor, are the members of the National Convention of Insurance Commissioners, their resolution of 1927 that the reserves in connection with these coupons are a part of the net value reserves, paid-for basis, is practically conclusive of the question at bar.

As Congress did not change the basis of this reserve deduction in its legislation adopted since the earlier Board of Tax Appeals and Court decisions on this

question, although in considering the 1934 tax act it gave special consideration to this deduction and in certain cases changed the rate for the computation thereof, it must be assumed that its action, especially in connection with the 1934 tax act, amounted to an acceptance and ratification of the decisions referred to.

ARGUMENT

THE RESERVE DEDUCTION

The decision of this Court in *New York Life Insurance Company* v. *Edwards*, 271 U. S. 109, and the other cases referred to therein, have established for life insurance companies the meaning of the words "reserve funds required by law" contained in the tax acts to be a sum of money set aside or reserved from premiums, with interest accretions thereon, with which to mature or liquidate either by payment or reinsurance with other companies the future unaccrued and contingent claims arising under the provisions of the insurance contracts for which such reserve funds are maintained.

Section 245 of the 1921 Revenue Act (c. 136, 42 Stat. 227), in effect in 1922, provided for the deductions from gross income in the computation of net taxable income thereunder. Paragraph (a) (2) thereof, as far as material here, is as follows:

> "(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, x x x."

This Court in *National Life Insurance Company of Vermont* v. *United States,* 277 U. S. 508, held that the diminishing of said 4% reserve deduction was unconstitutional and that life insurance companies were entitled to the full 4% reserve deduction thereunder.

VALUATION OF POLICIES EQUAL RESERVE FUNDS REQUIRED THEREFOR

During and prior to the year 1922 respondent was transacting business in the States of Idaho, Utah and Arizona. During the progress of the case, the business of the Inter-Mountain Life Insurance Company was taken over by the California State Life Insurance Company, of Sacramento, California (R. 2), which is now continuing said business there under the name of California-Western States Life Insurance Company.

Section 4, Chapter 3, Title 43, Revised Statutes of Utah, 1933, regarding stock life insurance companies, as far as material here, is as follows:

> "Said capital must be unimpaired, that is, the assets of such company must equal or exceed all liabilities for losses reported, expenses, taxes and other outstanding liabilities, including the legal reserves as provided in sections 43-3-12."

Section 43-3-12, mentioned therein, as far as material here, is as follows:

> "Sec. 12. Life insurance—Valuation of policies and reserves.—For the purpose of making valuations of life insurance policies and of determining the reserves required to be maintained therefor under the provisions of this title the rate of interest assumed shall be 3½ percent per annum, and the rate of mortality shall be established by the table known as the "American Experience Table of Mortality" for policies issued after January 1, 1910; x x x."

These provisions of the Utah law have been in effect continuously during and since 1922. Respondent did not begin business until the year 1911. Similar provisions of law for the valuation of life insurance policies and reserve requirements therefor are in effect in Idaho, Arizona and California, where the business of respondent is being transacted. Under these provisions of law, the valuations by the State insurance officials of respondent's policies of insurance, represented by the specimen policy (R. 11-19), are actuarily determined as provided by said statutes and are the reserves required by law therefor. It should be noted that these valuations are exclusively confined to the life insurance content of the policies. Such reserves equal the cash surrender and loan values of the policies and are the amounts required for the reinsurance thereof.

PROVISIONS AND CONDITIONS OF INSURANCE CONTRACT

An examination of the face of the specimen policy discloses that it grants insurance protection for $10,000.00 during the twenty year premium paying period, and at the end thereof, if, at the insured's option, the policy and accompanying coupons are surrendered to the company intact, it will merge into a full paid insurance contract under either Option 2, 3 or 4, unless the insured prefers the surrender value instead of the continued insurance therefor (R. 11). The surrender value named in Option 1 equals the amount of the single premium consideration for either of the full paid insurance contracts provided for by Option 2, 3 or 4. The valuation or reserve for a life insurance policy must necessarily be based upon the greatest insurance risk involved under the provisions of the

contract. Therefore, in order to secure the full paid insurance contract provided for by either Option 2, 3 or 4, this reserve at the end of the twenty year period must amount to $8,000.00, the surrender value provided for by Option 1.

The table in the specimen policy giving cash or loan values, exclusive of coupon values, shows that the cash surrender value at the end of the twenty year period for each $1,000.00 of insurance is $566.00 (R. 15). Hence, on this basis, the cash surrender value, or reserve, of the specimen policy for $10,000.00 at the end of the twentieth year amounts to only $5,660.00, while the surrender value, or reserve, of the specimen policy at the end of the twentieth year, as shown by Option 1, amounts to $8,000.00. The difference between these amounts must, therefore, consist of that part of the reserve which has accumulated on the coupon values until the end of the twentieth year.

From the above it will be seen that the values set out in the respective coupons are portions of the amounts which have been actuarily determined, set aside and reserved from the second and successive premium payments, in order, with the accumulations thereon, to provide the funds necessary to purchase the amount of paid up insurance contracted for at the end of the premium paying period; that is, the surrender value of the policy at that time.

In this connection, attention is called to the fact that the accumulations on these coupon values are necessarily determined in exactly the same manner as the accumulations on the other section of the reserve. The coupons attached to these policies form a very clever and ingenious device by means of which, if desired, the insured can surrender a part of his

insurance rights under the policy without at the same time abandoning his entire insurance protection thereunder. For this reason, we understand, that companies writing this class of policy usually carry two reserve accounts therefor, in order to simplify their bookkeeping and thus segregate the so-called coupon reserve section from the remainder of the reserve account. Thus when matured coupons are surrendered proper entries can be made therefor without disturbing the other section of the reserve account, unless at the same time the entire policy is surrendered. In regard to these coupons, it will be noted that they do not become accrued liabilities until they are presented for payment, which necessarily involves their surrender and the concurrent surrender of a part of the insurance protection of the insured under the policy, thus giving rise to such liability, the exact situation for all reserves. When a life policy is surrendered in toto, there being no further necessity for the maintenance of a reserve therefor, such reserve then becomes the surrender value of the policy. . .

RESOLUTION OF NATIONAL CONVENTION OF INSURANCE COMMISSIONERS

As under the provisions of the State laws requiring the annual valuation of life insurance policies by the State Insurance Departments, which valuations, also by statute, are made the reserves required by law therefor, the resolution of the National Convention of Insurance Commissioners, adopted in 1927, appears to be practically conclusive of the question at bar. This resolution, as quoted in the opinion of the Board of Tax Appeals in the *Standard Life Insurance Company* case, 13 B. T. A. 13, 26, is as follows:

"There has been some lack of uniformity among some companies which write so-called 'coupon policies' in the manner of reporting matured coupons which are not cashed by the policyholder as they become due but are permitted to accumulate and remain with the company to apply to the reduction of the premium paying period, the purchase of additional insurance, or some similar guaranteed policy benefit. The proceeds of such matured coupons are, clearly, held by such companies to meet guaranteed policy obligations at maturity. They are therefore reserves required by law and should be included in the reserves of the company reported above Line Seven on the Convention blank."

The reserves reported above Line Seven on the Convention annual statement blank to which this resolution refers are the "Net Reserve—Paid For Basis." This resolution is directly applicable in respondent's case, in view of the fully paid up provisions of the specimen policy (R. 11-12), and the further fact that for 1922 it did not include the reserves held by it in connection with matured and unsurrendered coupons as a part of its net reserve, paid-for basis, but reported them elsewhere in its annual statement. This resolution clearly shows, in the opinion of the Insurance Commissioners, who are the heads of the various State Insurance Departments and who determine by their valuations of policies the amount of reserves required by law therefor, that these reserves, in connection with unsurrendered coupons which had matured, were a part of the net reserves, paid-for basis, required by law for such policies.

PREVIOUS DECISIONS OF THIS QUESTION RATIFIED BY 1932 AND 1934 TAX ACTS

Since the decision of the Board of Tax Appeals in the *Standard Life Insurance Company* case, *supra*, affirmed by the Circuit Court of Appeals in 47 Fed. (2d) 218, and other similar decisions, Congress has had the revenue laws of 1932 and 1934 under consideration and has made no change in the basis for the deduction from gross income on account of reserve funds, although while the 1934 tax act was under consideration it gave special attention to this deduction and did provide that in certain cases the rate for the computation of such deduction should be reduced. Therefore, it must be assumed that Congress thereby accepted and ratified the decision of the Board of Tax Appeals, as affirmed in *Commissioner* v. *Standard Life Insurance Company, supra,* and the subsequent Board and Court decisions prior to the passage of the 1934 revenue act, as to the reserves to be used as the basis for the computation of this reserve deduction.

In support of and supplemental to the reasoning herein, see—*Standard Life Insurance Company of America* v. *Commissioner,* 13 B. T. A. 13, on appeal 47 Fed. (2d) 218; *Commissioner* v. *Western Union Life Insurance Company,* 61 Fed. (2d) 207, and *Commissioner* v. *Great American Life Insurance Company,* 70 Fed. (2d) 133.

CERTIFICATE AND AFFIDAVIT CONCERNING RESERVE REQUIREMENTS FOR SPECIMEN POLICY

For the information of the Court, we have included in the appendix a certificate of the Insurance Commissioner for the State of California, regarding the

valuation of respondent's coupon policies under the California statutes, and the inclusion of the so-called coupon reserves as a part of the total reserves for such policies.

For a like reason, we have also included in the appendix the affidavit of Marcus Gunn, formerly Actuary for respondent and now Associate Actuary of its successor, the California-Western States Life Insurance Company, setting up the reserves required by the California law for the specimen policy herein (R. 11-19).

CONCLUSION

For all of the foregoing reasons, it is submitted that the opinion of the Circuit Court of Appeals here under review should be affirmed.

Respectfully submitted,

STEPHEN W. DOWNEY,
A. R. SERVEN,
Attorneys for Respondent.

APPENDIX

STATE OF CALIFORNIA
DEPARTMENT OF INVESTMENT
DIVISION OF INSURANCE
SAN FRANCISCO

I, E. Forrest Mitchell, Insurance Commissioner of the State of California, do hereby certify that under the provisions of Section 629 of the Political Code of the State of California, covering valuation of life insurance policies, this Division requires the inclusion of so-called coupon reserves on policies such as the coupon policies of the Intermountain Life Insurance Company, reinsured by the California-Western States Life Insurance Company, as a part of the total reserve on coupon policies.

IN WITNESS WHEREOF I have hereunto set my hand and affixed my official seal this 2nd day of February, 1935.

E. Forrest Mitchell,
Insurance Commissioner.
Sgd. by Mae Barr Long,
Deputy.

[SEAL]

Affidavit Regarding Terminal Reserves

Sacramento, California,
February 2, 1935.

To whom it may concern:

This is to certify that the following table sets forth the exa t reserves by policy years which must be maintained by the Life Insurance Company in order to comply with the requirements of the California Laws

for valuation of life insurance policies as defined in Section 629 of the Political Code of California, for the Twenty Payment Life Coupon Policy of the Inter-Mountain Life Insurance Company, of the face amount of $10,000, issued at Age 35:

Terminal Reserves

End of Policy Year	"A" If reduced premiums are paid	"B" Coupon Section of Term. Reserve	"C" If full premiums are paid *
1	00.00	0.00	0.00
2	210.10	81.70	291.80
3	428.00	167.10	595.10
4	654.10	256.40	910.50
5	888.70	349.70	1238.40
6	1132.00	447.20	1579.20
7	1384.40	549.00	1933.40
8	1646.30	655.20	2301.50
9	1917.90	766.20	2684.10
10	2199.60	881.80	3081.40
11	2491.80	1002.40	3494.20
12	2794.70	1128.10	3922.80
13	3108.90	1259.10	4368.00
14	3434.60	1395.60	4830.20
15	3772.20	1537.80	5310.00
16	4122.30	1685.80	5808.10
17	4485.40	1839.90	6325.30
18	4862.30	2000.30	6862.60
19	5254.00	2167.20	7421.20
20	5660.00	2340.00	8000.00

Col. "A" plus Col. "B" equals Col. "C"

* NOTE—Column "C" shows the total reserve for the end of each policy year, which is required to be maintained by California Valuation Law for the above

described policy, when the full premium named in the consideration clause of the policy, $420.90 has been paid each year, the insured not having availed himself of the option of paying the premiums reduced by coupon amounts, and not having withdrawn that portion of the policy value represented by coupons. This reserve makes possible the granting of Options 1, 2, 3, and 4 which are available at the end of the 20th policy year.

MARCUS GUNN.

MARCUS GUNN, Fellow American Institute of Actuaries, Associate Actuary California-Western States Life Insurance Company, Sacramento, California.

[SEAL]

Sworn to and subscribed before me this 2nd day of February, 1935.

MARGARET E. DOHERTY,
Notary Public.

FILE COPY

NO. 537.

Office Supreme Court, U.
FILED
FEB 11 1935
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

INTER-MOUNTAIN LIFE INSURANCE COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE AND BRIEF

HOMER HENDRICKS,
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Amici Curiae.

920 Southern Building,
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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE

May it Please the Court:

The undersigned respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amici curiae.*

HOMER HENDRICKS,
GEORGE M. WOLCOTT,
O. H. CHMILLON,
Amici Curiae.

IN THE

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF AMICI CURIAE.

PRELIMINARY STATEMENT.

The undersigned are counsel for the taxpayers in the following cases: *Southern Union L. Ins. Co. v. Commissioner*, Docket Nos. 59328 and 64351, now pending before the

United States Board of Tax Appeals;[1] *Commissioner v. A. B. Chandler and Fidelity & Columbia Trust Co., Receivers, Inter-Southern L. Ins. Co.*, on appeal by the Commissioner to the United States Circuit Court of Appeals for the Sixth Circuit; and *Commissioner v. Montana L. Ins. Co.*, on appeal by the Commissioner to the United States Circuit Court of Appeals for the Ninth Circuit. In each of these cases, there is involved the question whether the taxpayers are entitled to deduct from gross income, four per cent of the mean of reserves maintained in respect of matured, unsurrendered coupons attached to life insurance policies of the type involved in the case now before this Court. The taxpayers represented by the undersigned have taken the position that they are entitled to such deductions.

QUESTION PRESENTED.

Whether reserves required by state law to be maintained on account of portions of the valuation of coupon life insurance policies represented by such coupons are "reserve funds required by law", within the meaning of Sec. 245 (a)(2) of the Revenue Act of 1921.

STATUTES.

Sec. 245(a)(2), Revenue Act of 1921, 42 Stat. 227, 261, provides that in the case of a life-insurance company the term "net income" means the gross income less—

> "(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life-insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for

[1] In these cases, the Board on Jan. 10, 1935, entered an order vacating and setting aside judgments previously entered for the taxpayer, pending the decision of this Court in the Inter-Mountain Case.

life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only."

SUMMARY OF ARGUMENT.

The coupon reserves were maintained to meet insurance obligations. They performed the same fundamental funtion as other true insurance reserves.

Precisely the same reason exists for allowing the deduction of four per cent of the mean of the coupon reserves as exists for allowing the same deduction in respect of other true insurance reserves. The amounts reserved in respect of the liability on the coupons represented a part of the gross premium paid by the insured, with interest accretions, the same as reserves in respect of other obligations of the policy.

The rule of allowing the deduction as interest paid, followed by the Bureau of Internal Revenue, results in a distortion of the annual net income. Under this method, the amount of deductible interest in any one year will depend on vicissitudes, such as the need of holders of coupon policies for funds (causing them to cash the amount of matured coupons and accumulated interest),—having no relation whatever to the fact that out of the "interest, dividends, and rents" received by the company in any year a certain proportion must be reserved for the purpose of carrying out its coupon policy contracts as a whole. On the other hand, by allowing four per cent of the mean of the reserves in any year, the net income is accurately computed, for the deduction from gross income is increased or decreased according to the requirements of the company to accumulate interest for the purpose of meeting the policy obligations.

The question involved in this case is not controlled by the decisions of this Court in the cases cited in the Commis-

sioner's brief. On the other hand, the opinion in *Williams v. Union Central L. Ins. Co.*, 291 U. S. 170, inferentially at least is in support of the proposition that the coupon reserves are true insurance reserves and thus "reserves required by law" within the meaning of the Federal income tax acts.

ARGUMENT.

1. The Coupon Reserves Were Maintained to Meet Insurance Obligations. They Performed the Same Fundamental Function as Other True Insurance Reserves.

It appears that the following propositions cannot be disputed:

(1) The coupons attached to the policies involved in this case were integral parts of the policy contract.

(2) The amounts which the insurance company reserved in respect of its liability on the coupons represented a part of the gross premiums paid by the insured, with interest accretions, the same as reserves in respect of other obligations of the policy.

(3) Higher premiums are charged for policies having the coupon feature than are charged for policies without coupons and the company issuing coupon policies must provide for its obligations under the coupon feature out of these premiums.

(4) The obligations of the insurance company in respect of the coupon feature of the policies were as much a part of the policy contract as were obligations to pay death claims as they arose, and it was as necessary to maintain reserves for one obligation as for the other.

The Commissioner's error lies, first, in his attempt to separate the coupon obligations from the other obligations of the policy, and second, in his refusal to recognize that the reserves maintained in respect of the coupons (whether they

are regarded as "accrued" or as "contingent" liabilities) performed the same fundamental function and are entitled to the same income tax treatment as other true insurance reserves.

Under the Commissioner's theory, it was as if the insured and the company had entered into two separate contracts—one which dealt with straight life insurance and another, a contract of mere deposit, which permitted the insured to make a loan to the company of a part of the sums which are described in the policy as premiums. The error of this theory was pointed out in the opinion of the Circuit Court of Appeals for the Third Circuit in the case of *Commissioner v. Standard L. Ins. Co.*, 47 F. (2d) 218, 219. In that case, Judge Buffington described the coupon policies of the Standard Life Insurance Company, which were similar in all essential respects to the policies here in question, as follows:

> "These coupon policies are in substance and in obligation the common form of life policies made more attractive to intended insurers, in that the substitution of a coupon for the ordinary yearly statement of accretions to the policy, whether the company chose to issue a coupon or gave a statement of amount, in no way lessened the obligation to ultimately and in some way pay such amount as part of the policy or keep in reserve a proper sum to insure its payment."

The opinion of those best qualified to reach an opinion, the National Convention of Insurance Commissioners, announced in a resolution adopted at their convention held in 1927, is that the amounts in question from the insurance standpoint are "reserves required by law." The resolution, quoted by the Board of Tax Appeals in *Standard L. Ins. Co.*, 13 B. T. A. 13, 26, stated:

> "* * * The proceeds of such matured coupons are, clearly, held by such companies to meet guaranteed policy obligations at maturity. They are therefore reserves required by law and should be included in the

reserves of the company reported above Line Seven on the Convention blank."

The reserve in respect of policies of this type is in reality a composite reserve, made up, first, of the reserve in respect of the twenty-year payment life features, and, second, of the reserve in respect of the coupon features. Either element in the composite reserve would not alone be sufficient to cover the obligation of the whole policy. Without the reserve in respect of coupons, the other portion of the reserve would be too low.

2. Precisely the Same Reason Exists for Allowing the Deduction of Four Per Cent of the Mean of the Coupon Reserves as Exists for Allowing the Same Deduction in Respect of Other True Insurance Reserves.

The reason for allowing the deduction in the case of life insurance policies not having coupon features is clear. Out of the total premium received, a certain portion must be reserved by the company, and interest accumulated thereon at a rate specified by the laws of the states, in order to enable the company to meet its obligations on the policy. Since the interest element in the reserve must be accumulated from "interest, dividends, and rents" (taxable gross income to life insurance companies under the revenue acts in question),[2] that portion of the gross income belongs to the policyholders, and from the standpoint of the company represents a cost of doing business and a proper deduction from gross income if it is to be taxed on its true annual income.[3]

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[2] Rev. Acts of 1921, 1924, and 1926, Sec. 244(a), Rev. Acts of 1928, 1932, and 1934, Sec. 202(a).

[3] In *National L. Ins. Co. v. United States*, 277 U. S. 508, 525, Mr. Justice Brandeis (dissenting) said in reference to the statutory provisions in question, "The reason for allowing the deduction of 4 per cent of the reserve is that a portion of the 'interest, dividends, and rents' received has to be used each year in maintaining the reserve, i. e., adding to it on the basis of a certain interest rate, varying from 3 per cent to 4 per cent according to the requirements of the statutes of the several states."

When the coupon features are added to the policy, precisely the same reason exists for allowing the deduction of the mean of the additional reserves required on account of the coupons. A certain part of the premium must be set aside and reserved for the policyholders.[4] Interest must be added to this amount annually, in order for the company to be able to meet its obligation under the policy. This interest must be accumulated from the "interest, dividends, and rents" of the company, in precisely the same manner as in the case of other reserves built up from premium payments with interest accretions thereto.

The deduction of four per cent of the mean of the "reserve required by law" was put in the Federal income tax acts in recognition of the fact that the life insurance business is conducted on the basis that policy obligations will be liquidated out of premiums, invested at an assumed rate of compound interest.[5] Thus, aside from administrative costs and the academic possibility of beating the mortality tables, an insurance company must earn the assumed rate of interest on its investment (aside from investments of original capital and surplus) to come out even. The four per cent of its reserves represents the cost of their maintenance. This interest element in the reserve for policies not having coupons is well understood, but it is equally true,

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[4] Since the coupon reserves are reserved from premiums, they are true insurance reserves, and clearly distinguishable from such "solvency" reserves as reserves for dividends (*Minnesota Mutual L. Ins. Co. v. United States*, 66 Ct. Cls. 481, cert. den. 279 U. S. 856) and reserves for unreported death claims and for the payment of annuities to former soliciting agents (*New York L. Ins. Co. v. Edwards*, 271 U. S. 109).

[5] In the instant case, the coupons bore interest at the rate of 3½ per cent, the same rate of interest prescribed by the Revised Statutes of Utah (Tit. 43, Ch. 3, Sec. 12, quoted on p. 46 of the Commissioner's brief) for policy valuations. There is, of course, a hiatus of ½ per cent between the 3½ per cent interest rate prescribed by Utah law and the 4 per cent deduction permitted by the Rev. Act of 1921, Sec. 245(a)(2), here involved. The hiatus is the same in the case of reserves for other features of the policies as for the coupon reserves. This is because Congress in drawing the Act fixed the 4 per cent deduction at the highest rate prescribed by the laws of the several states. Beginning with the Rev. Act of 1932, Sec. 203(a)(2), the taxing act has provided that "in the case of * * * a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum."

although not so well understood, that the company must also earn the same rate on the extra premium charged for the coupon feature. The contract as to these coupons is that the company will accumulate interest from their maturity until they are cashed, or until they are applied to one of the designated options. Thus, if the insured does not surrender the coupons at maturity, he must eventually be paid the interest; and the company must earn the interest on the premium charged for the coupon feature. If the insured elects one of the options, he will get increased benefits for which the company must have a reserve on hand. In any event the company must set up a reserve out of the excess premium paid for the coupon feature, and this reserve must earn the assumed rate of interest to enable the company to meet whichever one of the obligations it may incur.

In *McCoach v. Ins. Co. of No. America*, 244 U. S. 585, 589, this Court stated the purpose of the Act of 1909 in dealing with insurance reserves, as follows:

> "The act of Congress, on the other hand, deals with reserves not particularly in their bearing upon the solvency of the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation."

The foregoing statement is equally applicable to the Acts of 1921 and later years. In order to determine the taxable net income of a life insurance company, it is as necessary to allow the deduction of four per cent of the mean of the coupon reserves as it is to allow the deduction in respect of other true reserves.

3. The Rule of Allowing the Deduction as Interest Paid, Followed by the Bureau of Internal Revenue, Results in a Distortion of the Annual Net Income.

The practice of the Bureau of Internal Revenue is to disallow the deduction of four per cent of the mean of the coupon reserves (S. R. 9610, V-2 C. B. p. 189, cited on page

36 of the Commissioner's brief) and to allow a deduction only for interest actually paid during the year. See I. T. 2717, XII-2 C. B. p. 94, which states:

> "It is held that where coupons are left with the company[6] to accumulate at interest, the amount of such interest actually paid out in cash, or amounts applied to shorten the premium-paying period, or to purchase additional insurance, or to pay renewal premiums, which amounts are considered as the equivalent of cash payments, are allowable as deductions in computing the net income of the life insurance company."

The amounts of the deductions for any year under the two methods will vary greatly. For example, in the instant case, the Commissioner allowed only $897.58 as interest paid (R. 10), while four per cent of the mean of the coupon reserves amounted to $5,460.93 (R. 9).

Under the Commissioner's method, the amount of deductible interest in any one year will depend on vicissitudes such as the need of holders of coupon policies for funds (causing them to cash the amount of matured coupons and accumulated interest, or to use them for the payment of renewal premiums), the election on the part of any considerable number of policyholders to purchase additional insurance or to use the matured coupons for shortening the premium-paying period,—all having no relation whatever to the fact that out of the "interest, dividends, and rents" received by the company in any year a certain proportion must be reserved or set aside for the purpose of carrying out its coupon policy contracts as a whole.

That the annual net income of the company will be distorted by the use of the Commissioner's method seems

[6] The use by the Bureau of the words "left with the company" gives a hint as to its misconception of the terms of these policies and the function which the coupon features perform. The unsurrendered, matured coupons in respect of which reserves are necessary, remain attached to the policies, in the hands of the insured; they are not left with the company, and the company does not know what use the insured will make of them under the various options contained in the policy contract.

clear. In one year, the net income will be understated by an excessive allowance for "interest paid"; in another year, such as is here in issue, the net income will be overstated by the allowance of only a nominal amount for "interest paid."

On the other hand, by allowing four per cent of the mean of the reserves in any year, as a deduction from gross income, the net income of the company for any year is accurately computed, for the deduction is increased or decreased according to the requirements of the company under its contracts to accumulate interest for the purpose of meeting the policy obligations.

4. The Question Involved in This Case is Not Controlled by the Decisions of This Court in the Cases Cited in the Commissioner's Brief.

The Commissioner cites and relies on the decisions of this Court in *McCoach v. Ins. Co. of No. America*, 244 U. S. 585, *United States v. Boston Ins. Co.*, 269 U. S. 197, and *New York L. Ins. Co. v. Edwards*, 271 U. S. 109.

These cases arose under the Acts of 1909 and 1913, imposing excise and income taxes. Under these acts insurance companies were required to include premiums in gross income. The compensating deduction was "the net addition, if any, required by law to be made within the year to reserve funds."[7] In the McCoach Case this Court held that in the case of a company writing fire and marine insurance, reserves for unpaid fire and marine losses did not constitute "reserve funds required by law" so as to entitle the company to deduct the net addition thereto. The company was permitted by the law to deduct the net additions to reserves that were set up in anticipation that losses would occur, and had it been permitted to set up a further addition to the reserve when the losses did occur, a dupli-

[7] Corpn. Excise Tax Act (1909) 36 Stat. 11, 113; Rev. Act of 1913, 38 Stat. 114, 176.

cation would have resulted and net income would have been understated.

United States v. Boston Ins. Co. (in effect overruling *Maryland Casualty Co. v. United States*, 251 U. S. 342) involved a claim for a deduction for the net addition to a reserve for unsettled fire and marine losses. This Court denied the claim on the ground that the reserve in question was not a "reserve required by law." Here, again, the company had on hand already a reserve for anticipated losses, and had it been permitted to deduct the net addition to a new reserve reflecting the actual occurrence of the losses, there would have been in part a duplication of the former reserve.

New York L. Ins. Co. v. Edwards involved the claim of a life insurance company for a deduction of the net addition to a reserve for unreported death claims.[8] The taxpayer's claim was denied on the ground that such a reserve did not constitute a "reserve required by law." The taxpayer already had a reserve in anticipation of death claims, and if it had been permitted to set up a further reserve when the death claims actually occurred, a partial duplication would have resulted.

There is no question of duplicate reserves in the instant case. Admittedly no reserve existed for the coupon obligations until the reserve in question was set up.

The opinion of this Court in the New York Life Case states, in reference to the reserve for unreported death claims:

> "• • • The item under consideration represented a liability and not something reserved from premiums to meet policy obligations at maturity.'"[9]

[8] The case also involved a reserve for the payment of annuities to former soliciting agents, which was, of course, clearly a "solvency" reserve.

[9] 271 U. S. 109, 119.

The coupon reserves in the instant case represented something reserved from premiums, and their purpose was to meet policy obligations at maturity.

On the other hand, the opinion of this Court in *Williams v. Union Central L. Ins. Co.*, 291 U. S. 170, inferentially at least is in support of the proposition that the coupon reserves are true insurance reserves and thus "reserves required by law" within the meaning of the Federal income tax acts. In that case this Court had before it the question whether a dividend due an insured was required to be applied by the company to extend a policy which was otherwise in a lapsed status at the time of the insured's death. This Court held that the dividend was not required to be so applied. The decision was in part based on the conclusion that the dividend was not a part of the "surrender value" of the policy which, had it been sufficient for the purpose, the company would have been required to apply to the purchase of extended insurance. Counsel for the beneficiary evidently relied on *Great Southern L. Ins. Co. v. Jones*, 35 F. (2d) 122 (C. C. A., 8th), in which it was held that the Great Southern Company could not forfeit a policy for nonpayment of the premiums where it held uncashed premium reduction coupons of the insured that were sufficient to extend the policy. Mr. Chief Justice Hughes in distinguishing the Great Southern Life Case, said:

> "In Great Southern L. Ins. Co. v. Jones * * * relating to a similar statute of Oklahoma, the policy provided for guaranteed 'premium reduction coupons' which were fixed liabilities requiring a reserve, and were not dividends in the proper sense as in the instant case."[10]

Apparently, it was the view of this Court that the coupon reserves were a part of the cash surrender value of the policy, hence, a part of the general insurance reserve.

Without further comment, we adopt the reasoning of the

[10] 291 U. S. 170, 182.

decisions in the following cases, which we urge upon this Court as high persuasive authority for the Respondent's position: *Commissioner v. Standard L. Ins. Co.*, 47 F. (2d) 218 (C. C. A., 3d), affirming 13 B. T. A. 13; *Commissioner v. Western Union L. Ins. Co.*, 61 F. (2d) 207 (C. C. A., 9th); *Commissioner v. Great American L. Ins. Co.*, 70 F. (2d) 133 (C. C. A., 10th); and the opinion of the lower court in the instant case, 71 F. (2d) 962.

CONCLUSION.

It is respectfully submitted that the decision of the court below is correct and should be affirmed.

Respectfully submitted,

HOMER HENDRICKS,
GEORGE M. WOLCOTT,
O. H. CHMILLON,
Amici Curiae.

February, 1935.

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Supreme Court of the United States

OCTOBER TERM, 1934.

No. 537.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

VS.

INTER-MOUNTAIN LIFE INSURANCE COMPANY, RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF OF AMICI CURIAE.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF OF AMICI CURIAE.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE.

Come now the undersigned, members of the bar of this court, and move for leave to file a brief in this cause as *amici curiae*, and in support thereof your movants state that they represent other life insurance companies who will be affected by the decision of the court herein and that your movants believe the presentation of their views of the cause may assist in the consideration of the issues involved.

THOMAS WATTERS, JR.,
EDWIN R. MORRISON.

BRIEF OF AMICI CURIAE.

OPINION BELOW.

The opinion of the circuit court of appeals is reported in 71 F. (2d) 962. The Board of Tax Appeals handed down no opinion.

JURISDICTION.

The jurisdiction of the court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925. The charge of the circuit court of appeals was entered June 25, 1934. (Rec. p. 26.) By an order entered by justice of this court on September 21, 1934, the time for filing a petition for a writ of certiorari was extended for sixty days from and after September 25, 1934. (Rec. p. 27.) The petition for a writ of certiorari was filed November 22, 1934, and the writ was granted January 7, 1935. (Rec. p. 27.)

QUESTION PRESENTED.

Whether certain funds held by the respondent at the beginning and end of the taxable year 1922 against its obligations to policyholders under certain guaranteed premium reduction coupon policies, in respect of coupons theretofore matured and unsurrendered, constitute "re-

serve funds required by law'' within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

STATUTES AND REGULATIONS INVOLVED.

Section 245 (a) (2) of the Revenue Act of 1921, C. 136, 42 Stat. 227, 261; Article 681 of Treasury Regulations 62, as printed in the appendix to petitioner's brief; and Title 43, Chapter 3, Sections 4 and 12, Revised Statutes of Utah, 1933.

STATEMENT.

This case involves the federal income tax liability of the respondent life insurance company for the calendar year 1922, and arises out of the disallowance by the Commissioner of Internal Revenue of a deduction claimed by respondent under Section 245 (a) (2) of the Revenue Act of 1921 in respect of funds held by respondent at the beginning and end of said year to cover respondent's liability upon certain "guaranteed premium reduction coupons" attached to and forming parts of policies of life insurance theretofore issued by respondent and then in force. Upon redetermination of the deficiency of income tax for said year, proposed by the Commissioner of Internal Revenue and predicated, among other things, upon the disallowance of said deduction, the United States Board of Tax Appeals held that the deduction should have been allowed, and redetermined the deficiency accordingly. The decision of the Board of Tax Appeals was affirmed by the Circuit Court of Appeals, Tenth Circuit, on June 25, 1934.

The coupon policies of respondent outstanding and in force at the beginning and end of the taxable year 1922 were in the form commonly known and denominated as "Twenty Payment Life" policies. Each of such policies at the time of issuance thereof bore a sheet of nineteen coupons, one such coupon maturing on each of the first nineteen anniversaries of the policy. Each such coupon constitutes the promise and obligation of the respondent to pay to the owner of the policy to which such coupon is attached a specified amount of

money, provided all premiums previously due on the policy have been paid. (Rec. p. 14.)

The rights and options of a policyholder with respect to the coupons attached to his policy are not set forth in the coupons themselves but are contained in the policy to which the coupons pertain. Those rights and options are as follows:

(1) The matured unpaid coupons may be applied to the payment of premiums.

(2) The matured coupons may be left with the company to be improved with compound interest at the rate of 3½ per cent per annum, the whole amount of such matured coupons and interest thereon to be subject to withdrawal by the policyholder in cash at any time and in event of the death of the insured to be paid to the beneficiary in addition to the face amount of the policy as an additional death benefit.

(3) If the first fourteen coupons are left with the company to accumulate at interest as aforesaid, the company will at the request of the insured at the end of fifteen years from the date of the policy issue to the insured a paid-up policy in the full face amount of the policy. Or, to state it another way, the matured coupons may be used to reduce the premium-paying period of the policy.

(4) The matured coupons may be used by the policyholder at the end of the twentieth policy year to mature the policy as an endowment for a specified amount or to purchase certain paid-up additions to the face of the

policy. Such paid-up additions may be in the form of life insurance alone or life insurance combined with life annuities to the insured.

(5) The coupons as they mature, or within one month after the respective due dates thereof, may be used to purchase paid-up additions to the policy in the amounts shown on the reverse sides of the several coupons.

The coupons and accumulated interest thereon with which we are concerned in this case are those which at the beginning and at the end of the calendar year 1922 had matured, but which had not been either (a) surrendered by the policyholders for cash, or (b) surrendered by the policyholders to be applied upon premiums, or (c) utilized for the purchase of paid-up additions. With respect to the coupons involved in this case the policyholders remained free to choose any one of the several options granted under the provisions of the policies to which such coupons were attached.

In view of the aforesaid provisions of respondent's coupon policies, the question here to be determined is whether or not the funds held by respondent to cover its liability upon all such matured unsurrendered coupons at the beginning and end of the calendar year 1922 constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921, so that respondent was entitled to deduct from gross income four per cent of the mean of such funds held at the beginning and end of said taxable year. It is conceded by the petitioner that the respondent was required by the laws of Utah to have on hand at all times assets at least equal in amount to its total liabilities including all matured, unsurrendered coupons, and that the respondent actually had and held such assets at the beginning and end of the year 1922. (Petitioner's Brief p. 22.)

SUMMARY OF ARGUMENT.

The purpose of the deduction provided by Section 245 (a) (2) of the Revenue Act of 1921 is to eliminate from the taxable income of life insurance companies that portion of the investment income of the companies which is required by virtue of their policy obligations to be added to reserve funds. This purpose evidenced by the clear legislative intent of the Congress in effect constitutes a test for "reserve funds" as that term is employed in the Revenue Act. The funds held by respondent against its liability upon matured and unsurrendered coupons meet the aforesaid test because they are policy obligations and are contingent liabilities of the company and involve life insurance obligations which the company can prepare itself to meet only by the maintenance of reserves which are continually increased by crediting thereto interest thereon at 3½ per cent. Although contesting the contention of the petitioner which attempts to lay down another test for reserve funds, nevertheless the coupon reserve here in question, in view of the obligations of the company under the terms and provisions of its policies, comply in every respect with the test contended for by petitioner. The position taken by the petitioner in this case is unsupported by the language of the Revenue Act and likewise by the history of the administrative interpretation thereof by the Treasury Department.

There is a valid distinction between the coupons involved in this case and dividends upon participating policies, and the decisions holding that declared dividends do not constitute reserve funds required by law within the meaning of the revenue acts have no applicability to the issues in this case. All of the decided cases upon this precise point are adverse to the contentions of the petitioner except one decision of the court of claims which for all of the reasons above stated is erroneous and should not be sustained.

ARGUMENT.

I.

The Purpose of the Reserve Deduction.

In the revenue acts prior to the Act of 1921 life insurance companies were required to include in gross income for federal income tax purposes their income from all sources, including premium or underwriting income as well as income from invested funds. Under such acts the companies were permitted a deduction from gross income in the amount of the "net addition, if any, required by law to be made within the year to reserve funds." Section 38 of the Corporation Excise Tax of August 5, 1909, C. 6, 36 Stat. 11, 12; Act of October 3, 1913, C. 16, 38 Stat. 166, 171-173; Act of September 8, 1916, C. 463, 39 Stat. 756, 765, 768; and Revenue Act of 1918, C. 18, 40 Stat. 1057, Section 234 (a) (10).

In the Revenue Act of 1921 and the succeeding acts, a new system of taxation of life insurance companies was prescribed. The Act of 1921 and subsequent acts require life insurance companies to return in gross income only their income from interest, rentals and dividends, that is to say, their investment income. Premium income is not required to be returned: Section 244, Revenue Act of 1921, 42 Stat. 227.

By reason of this change in the definition of gross income, the Act of 1921 and subsequent acts made certain changes in the deductions permitted to life insurance

companies. Since 1921 such companies have been permitted a deduction in the amount of 4 per cent of the mean of all "reserve funds required by law" and held at the beginning and end of the taxable year. A life insurance company is no longer permitted to take a deduction in the amount of net additions to reserve funds during the taxable year.

Neither in the acts prior to 1921 nor in the Act of 1921 and subsequent acts has the Congress defined the term "reserve funds" as used therein. In attempting to determine the legislative intent and to lay down a test by which it may be ascertained what constitutes reserve funds and what does not, it becomes pertinent to inquire why life insurance companies are allowed any deduction for or in respect of their reserve funds. The reason becomes apparent when one considers the inherent nature of the life insurance business, particularly in connection with the legal requirements to which life insurance companies are subjected by the laws of the various states. The company by virtue of its outstanding policy contracts and the obligations contained therein is required each year to increase its reserves by crediting thereto interest thereon at a specified rate (in this case 3½ per cent) and by adding thereto a portion of the premiums collected during the year. In other words, the sources from which the reserves of respondent are derived are (1) premiums and (2) earnings upon investments in which the reserve funds of the company are invested. It is obvious that so long as the revenue acts required the company to include all of its income in gross

income for tax purposes, premium income as well as investment income, it was necessary to permit the company to deduct from gross income the entire amount which it was required during the taxable year to take out of gross income and to set aside as a part of its reserve funds for the security of its policyholders. It would have been grossly unfair and would have tended to defeat the very purpose of the valuation statutes of the states requiring life insurance companies to have and maintain reserves if the tax had been levied upon the entire income of the company when, as a matter of fact, the company was not free to use all of that income as it saw fit, but was required by the laws of the state in which it was organized and did business to set aside a portion of such income as reserve funds for the security of policyholders. Such income so required to be set aside for the security of policyholders in legal effect belongs to the policyholders and is not fairly to be considered as income to the company for tax purposes.

When in the Act of 1921, life insurance companies were relieved of the requirement that they return premium income as a part of gross income for income tax purposes, it became apparent that the company was no longer entitled to a deduction in the full amount of the additions made to reserve funds during the taxable year, for the reason that a portion of such additions to reserves came out of premium income which was no longer taxed. It was equally apparent, however, that the company was still entitled to some deduction in respect of that portion of its taxable income which it was

required to set aside and credit to reserve funds for the security of its policyholders. The invested assets of a life insurance company from which its taxable income is derived are, generally speaking, the assets in which its reserve funds are invested, and the income from such investments constitutes the source of the interest which is required to be added to reserve funds. The Congress, therefore, provided in the 1921 Act that the company should be entitled to take a deduction from gross income for tax purposes in an amount approximately equal to the part or portion thereof which the company was required to credit or add to reserve funds in accordance with the rate of interest assumed by the company in order to provide funds with which to meet its policy obligations at maturity. A great many companies assume interest at 4 per cent. Other companies assume interest at 3½ per cent. As a matter of convenience and uniformity for income tax purposes, the Congress provided that life insurance companies should be entitled to deduct from their investment income an amount equal to 4 per cent of the mean of reserve funds required by law and held at the beginning and end of the taxable year.

The control which a life insurance company is permitted to exercise over reserve funds is strictly limited and circumscribed by the statutes of practically all states. Such funds can be invested by the company only in securities of the kind prescribed by statute. In many states the securities in which such funds are invested must be physically deposited with a designated deposi-

tary. In any event the company is required to maintain the funds intact and without impairment. To the extent that the earnings of such funds are required by law to be added to the principal of the funds, such earnings do not constitute income to the company in any true sense of the word. The purpose of the deduction allowed by Section 245 (a) (2) of the Act of 1921, therefore, is to relieve the company of the payment of income taxes upon such part of the income from invested reserve funds as is required by law to be added to the principal of such funds. To levy a tax upon the income from such funds might have the effect of impairing the funds themselves because the remaining income after payment of the tax would be insufficient to increase the funds at the rate assumed and required by law. Thus the Federal Income Tax Law would thwart the purpose of the state valuation statutes and might impair the obligations assumed by the company in its policy contracts.

It becomes apparent from this consideration of the theory of the revenue acts as applied to life insurance companies that the Congress intended that a life insurance company should be permitted to include as reserve funds for the purpose of computing its deduction under Section 245 (a) (2) of the Act of 1921, all of those funds which it holds to cover policy obligations to its policyholders and which it is required by virtue of its policy obligations to improve with interest in accordance with the method adopted by it for computing its reserves.

That this is the legislative intent is clearly indicated by the report of the Senate Finance Committee on the Revenue Act of 1932. A change was made in the 1932 Act in that the reserve deduction was decreased to 3¾ per cent of the mean, in respect of those reserves which are computed at an interest assumption rate lower than 4 per cent. In commenting upon this change the Senate Finance Committee said:

> "In view of the fact that by far the greater part of the reserves for life insurance policies are maintained at rates less than 4 per cent, the effect of the existing law was to permit companies maintaining their reserves at such lower rates to take deductions substantially in excess of their actual reserve requirements. * * *
>
> "In the judgment of your committee, the substantial purpose of the act, to permit a life insurance company to set aside free of tax the amount of investment income actually required to maintain the policy reserve, is best accomplished by requiring the deduction to be computed at the interest rate at which the policy reserves are actually maintained. Since few, if any, policy reserves are maintained at rates in excess of 4 per cent, the rate at which such deduction may be computed may not exceed 4 per cent. If a company maintains its reserves at different interest rates, the deduction must be computed by applying to each part of the reserve the rate at which such part is maintained."

The legislative intent and purpose evidenced by the above-quoted language of the finance committee is also recognized in the dissenting opinion of Mr. Justice Brandeis in *National Life Insurance Company* v. *United States*, 277 U. S. 508, 525.

II.

The Reserve Funds of the Respondent Held Against Its Liability upon Matured Unsurrendered Coupons Meet the Test Laid Down by the Statute.

A. THE COUPONS ARE POLICY OBLIGATIONS.

The coupons attached to respondent's coupon policies constitute an integral part of the life insurance contracts between the company and the policyholders. The full extent of the company's obligations and liabilities upon such coupons cannot be ascertained by reference to the coupons alone, but must be ascertained from the provisions of the policy contracts themselves. The coupons are neither negotiable nor separately transferable. They are payable in cash only to the insured or to the owner of the policy. If they are paid as an additional death benefit, they are payable only to the beneficiary of the policy. If they are utilized for the payment of premiums or for the purchase of paid-up additions to the policy, they are available only to the insured or owner of the policy. Under no theory can such coupons be said to constitute independent contracts between the insured and the insurer. They are not mere unrelated promises to pay money. They are as much a part of the contract between the company and the insured as any other part of the policy provisions. *Miller* v. *Western Union Life Ins. Co.*, 106 Wash. 490, 180 Pac. 488. The company cannot disregard the coupons in ascertaining the extent of the life insurance obligations it has assumed to the insured.

B. THE COUPONS ARE CONTINGENT LIABILITIES OF THE INSURER.

No life insurance obligation is contingent in the sense that it is indefinite *whether* the insurer will ever be called upon to pay. The event insured against is certain. A life insurance company knows that every policy it issues will some day become a death claim if the policy is kept in force, but it does not know the time nor the order in which such claims will accrue. Likewise the liability of the company on matured unsurrendered coupons is contingent. The time and method of payment of coupons rest solely in the choice of the policyholder, free of any control by the insurer. The company may be called upon to pay the amount of matured coupons and interest thereon in cash at any time prior to, or at the death of, the insured. It may be called upon to discharge its obligation upon matured coupons by issuing to the insured additional paid-up insurance in any one of several forms or combinations of forms. The time at which the company may be called upon to discharge its obligation upon such coupons and the method in which the company will be required to discharge such obligation are not susceptible of ascertainment prior to the exercise by the policyholder of the rights and options vested solely in him. The greatest possible liability of the insurer at any given time is definite, however, and it is this maximum liability which the company must keep itself in readiness to meet whenever the contingency over which it has no control occurs. See *Pacific States Life Ins. Co.* v. *Bryce*, (C. C. A. 10) 67 F. (2d) 710.

C. THE COUPONS INVOLVE LIFE INSURANCE OBLIGATIONS WHICH THE COMPANY CAN PREPARE ITSELF TO MEET ONLY BY THE MAINTENANCE OF RESERVES TO WHICH INTEREST IS CREDITED AT 3½ PER CENT.

A consideration of the options granted to the holder of a coupon policy at the end of the twentieth policy year demonstrates the correctness of respondent's theory of this case. It is provided in the body of the policy—not in the coupons—that, if all premiums have been paid in cash and if all coupons have been left with the company to accumulate at interest, the insured *shall* select one of four options given to him. All of these options involve life insurance in excess of the original face amount of the policy. For convenience we shall illustrate this proposition by referring specifically to the specimen coupon policy for $10,000.00, issued at age 35, appended to the agreed statement of facts in the Board of Tax Appeals as Exhibit A. (Rec. p. 11.) The court will take judicial notice of the American Experience Table of Mortality which with the interest assumption rate of 3½ per cent forms the reserve basis of respondent's coupon policies.

Option 1 (at the end of the twentieth policy year) provides that the policy will endow at said time for $8,000.00. (Rec. p. 11.) It is obvious that the policy exclusive of coupons could not possibly endow for any such sum at the twentieth year. Being based on the American Experience Table of Mortality, assuming interest at 3½ per cent, the policy would endow for the face amount at age 96 of the insured. The values in the policy which make the twentieth year endowment

for $8,000.00 possible are as follows: Reserve, exclusive of coupons, $5,660.00; and accumulated coupons and interest, $2,340.00. If interest is not credited to coupons at 3½ per cent, compounded from the respective due dates of the coupons, the company at the end of the twentieth policy year will find itself in the position of having agreed to pay the insured $8,000.00 without having sufficient funds on hand to make the payment. In this respect, therefore, the company must accumulate its reserves much more rapidly than upon a simple "Twenty Payment Life" policy without coupons.

Option 2 provides that the insured may demand a paid-up policy for life of $14,130.00. (Rec. p. 11.) The attained age of the insured at the end of the twentieth policy year is 55. The net single premium required to purchase $14,130.00 of paid-up insurance for life at age 55 is $7,999.70, based on the American Experience Table and assuming interest at 3½ per cent. The values contained in the coupon policy available to provide such net single premium are as follows: Reserve, exclusive of coupons, $5,660.00; accumulated coupons and interest, $2,340.00. (For convenience values are adjusted to the nearest dollar.) Again, in this option, the company must accumulate reserves more rapidly than upon a simple "Twenty Pay Life" policy or it will not have sufficient funds on hand to provide the additional insurance which it has agreed to give the insured at the end of the twentieth policy year. Furthermore, the company must credit interest to matured coupons at 3½ per cent or it will not have sufficient funds to meet

its life insurance obligation at the end of the twentieth policy year.

A similar analysis of each of the four twentieth year options might be made, and in each case the figures will demonstrate that the company has made a contract to insure the life of the insured, without the payment of additional premium, for amounts which make it mandatory upon the company to maintain reserves in excess of the reserve upon a simple "Twenty Pay Life" policy without coupons. This additional reserve is made up out of the matured coupons and interest thereon, and based on the American Experience Table with interest at 3½ per cent is the single premium necessary to provide the additional insurance provided by the policy. The principal of the coupons alone is not sufficient. A deficit exists unless interest is credited to matured coupons at 3½ per cent.

Therefore, inasmuch as the funds held by the company against its obligations to the policyholder upon matured coupons are required to be improved with interest in order to enable the company to meet its policy obligations at maturity, such funds necessarily constitute "reserve funds" within the meaning of the Revenue Act.

III.

The Coupon Reserves Also Meet the Technical Test Contended for by Petitioner.

An attempt has been made to cloak the coupon reserves which are involved in this case with such technicality that the real purpose of the deduction permitted

by Section 245 (a) (2) of the Revenue Act will be lost sight of. It is said that the liability of the company upon matured coupons is not a life insurance obligation. A complete answer to that contention is found in the provisions of the coupon policies themselves. The insured is entitled to have his additional paid-up life insurance merely by demanding it. No option or discretion concerning the matter is vested in the company. It has in legal effect insured the life of the insured for an amount in excess of the original face amount of the policy. The actual placing of the additional insurance in force awaits only the determination by the insured of the exact form of insurance he desires. The company is bound as effectively as if the additional insurance were put in force at the original issuance of the policy. That this is so has been recognized by this court in *Williams* v. *Union Central Life Insurance Company*, 291 U. S. 170. There the court was concerned with the nature of certain funds in the hands of the company and the duty of the company to employ those funds for the purpose of preventing lapse of the policy for nonpayment of premium. The result reached by this court would have had the possible effect of overruling the opinion of the court of appeals in *Great Southern Life Ins. Co.* v. *Jones*, 35 F. (2d) 122, had not the opinion of this court recognized and pointed out the important differences between dividends upon participating policies and coupons constituting part of nonparticipating policies. Thus it was pointed out in the opinion by Mr. Chief Justice Hughes that the guaranteed premium reduction coupons before the court in

that case were "fixed liabilities requiring a reserve, and were not dividends in the proper sense as in the instant case." There is no difference between the coupons involved in the *Great Southern Life Case, supra*, and those involved in this case, except in minor details.

It is said that the coupon reserves are not calculated upon the basis of a motality table and, therefore, do not constitute "reserve funds" within the meaning of that term as used in the revenue acts. It will be pointed out in a subsequent portion of this brief that such a test is not contemplated either by the Revenue Act or by the administrative interpretation placed on the act by the Secretary of the Treasury. But, even if such were the test, the coupon reserves meet it absolutely and unconditionally. It has been demonstrated that the coupons are designed with interest thereon at 3½ per cent to produce the fund necessary to enable the respondent to provide the paid-up life insurance additions which the insured by virtue of policy provisions is entitled to demand and receive at designated times. The amounts necessary to provide such paid-up life insurance additions are scientifically and actuarially determined, based upon the American Experience Table of Mortality, assuming interest at 3½ per cent. The amount of additional insurance for which the company has bound itself by policy contract is specific and definite. The age of the insured is known. The calculation of the net single premium required to provide such amount of additional paid-up life insurance is a distinctly actuarial function based upon the application of the mortality table and the interest assumption

rate. It is scientific and exact. How, then, can it be said that the amounts of the coupons, which, with their accumulated interest at the aforesaid assumed rate, are designed to produce such net single premium, are not actuarially determined?

It is also said that the policyholder may surrender his matured coupons for cash without surrendering his life insurance. This statement will not withstand analysis in the light of the provisions of the policy contract in evidence in this case. A policyholder who surrenders his matured coupons for cash has as effectually surrendered a part of his life insurance as if he had drawn down half of the surrender value of a noncoupon policy and had thereby reduced the amount of insurance in force by a corresponding amount. He has surrendered a policy which will be paid up for the face amount at the end of fifteen years, and he has in its place a policy which will be paid up for the face amount at the end of twenty years. He has surrendered a policy which will be paid up for $14,130.00 at the end of twenty years, and he has in its place a policy which will be paid up for only $10,000.00 at the end of twenty years. By surrender of his matured coupons for cash the policyholder has surrendered a life annuity of $174.40 beginning at the end of the twentieth policy year. In any event, even if petitioner's argument were sound, it involves the attempted application of a test for "reserve funds" which is entirely outside the provisions of the Revenue Act and the treasury regulations.

It is said that the coupon reserve is a mere "solvency reserve." The same thing might be said with equal truth of every reserve a life insurance company maintains. The reserve is an actuarial device by which the company, being manifestly unable to charge itself with a liability equal to the face amount of all outstanding policies, nevertheless charges itself at all times with such an amount of liability upon outstanding policies that by maintaining funds to cover such liability it can pay its policy obligations as they mature. Every reserve, therefore, is a part of the test of the solvency of the company. If it were not so the valuation statutes of the several states would be vain and useless. It may be conceded that the mere designation of a fund as a reserve is not sufficient to constitute the same a "reserve fund" within the meaning of the Revenue Act. But if the fund in question is one held and maintained by the company against an obligation or obligations assumed by it to policyholders under the terms and provisions of outstanding policies, and if it is necessary for the company to improve such fund by crediting thereto interest thereon in order to enable the company to accumulate the funds necessary to discharge such policy obligations as they mature, that fund meets the test for "reserve funds" contemplated by the Revenue Act and it also meets the hypertechnical test contended for by the petitioner. It is something more than a mere test of solvency. It is an inherent necessity of the insurance business, necessary for the purpose of providing funds with which to discharge policy obligations.

IV.

The Contention of the Petitioner Finds No Support Either in the Language of the Revenue Act Or in the Administrative Interpretation Thereof.

In the foregoing paragraphs of this brief we have presented reasons and arguments which we believe establish the unsoundness upon principle and in theory of the arguments advanced by the petitioner in this case. Entirely aside from the soundness or fallacy of petitioner's arguments, however, is the practical consideration that petitioner attempts to lay down a test for "reserve funds" which finds no support either in the revenue acts or in the administrative interpretation thereof by the Treasury Department. Neither the revenue acts nor the treasury regulations have ever limited or circumscribed the definition of the term "reserve funds" in the manner or to the extent contended for by the petitioner in this case. The court will take judicial notice of the income tax regulations promulgated by the Secretary of the Treasury pursuant to authority of law and of the official income tax return forms prescribed by said regulations for the use of life insurance companies. *Caha* v. *United States*, 152 U. S. 211. Article 681 of Regulations 62 is printed in the appendix to petitioner's brief. (pp. 44, 45.) Nowhere in the regulations is it required that reserve funds of life insurance companies include only such funds as are held against the contingency of death. On the contrary, the regulations expressly recognize that life insurance companies maintain reserve funds against policy obligations other than those containing life contingencies. Thus Article 681 of Regulations 62 provides,

"* * * Generally speaking, the following will be considered reserves as contemplated by the law: Items 7, 8, 9, 10 and 11 of the annual statement for life companies, * * *."

Items 7, 8, 9, 10 and 11 of the annual statement (convention edition) of life companies are as follows:

7. Net reserve (paid-up basis).
8. Extra reserve for total and permanent disability benefits; and for additional accidental death benefits included in life policies.
9. Present value of amounts not yet due on supplementary contracts *not* involving life contingencies.
10. Present value of amounts incurred but not yet due for total and permanent disability benefits.
11. Liability on policies cancelled and not included in "net reserve" upon which a surrender value may be demanded.

United States Internal Revenue Form 1120L, prescribed by Regulations 62 as the official form for use by life insurance companies in making their corporation income tax returns for the calendar year 1921, provide a Schedule C upon which the companies are required to itemize the reserve funds which they have included in the computation of the deduction allowed by Section 245 (a) (2) of the Act of 1921, as follows:

1. Reserve for outstanding policies and annuities.
2. Reserve for disability and accidental death benefits.
3. Reserve for supplementary contracts.
4. Reserve for incurred disability benefits.

5. Reserve for policies upon which a surrender value may be determined (not included elsewhere).
6. Deposits made with state officers by assessment companies, as required by law.
7. Other reserve funds, if any (attach itemized statement).

The above-quoted language from Regulations 62 survive the treasury regulations today and has been incorporated in all regulations promulgated since 1921. The official return form today contains the same items in Schedule C as are set out above, as have all return forms prescribed for life insurance companies since 1921. Such a consistent history of administrative interpretation of the revenue acts during a period in which the Congress has time and again reenacted Section 245 (a) (2) of the 1921 Act without change places beyond doubt the conclusion that the Congress intended that the term "reserve funds" as used in the act is not to be limited to those funds held against the contingency of death, but includes all funds held against any and all policy obligations of a life insurance company if the company in order to fulfill its policy obligations is required to improve such funds with interest at the rate assumed by the company as a part of its reserve basis. If the Congress had not been satisfied with the interpretation placed upon the act by the Treasury Department, or, if the Congress had intended to include in "reserve funds" only those funds held against the contingency of death, it undoubtedly would have changed the law so to provide.

Petitioner attempts to avoid the force of this argument by directing attention to Section 245 (a) (8) of the Revenue Act of 1921, which grants to the taxpayer life insurance company a deduction from gross income in the amount of interest paid or accrued on indebtedness. The deduction for interest paid granted by Section 245 (a) (8) of the Revenue Act of 1921 is limited fo interest upon the *indebtedness* of the company. It does not include interest credited upon the reserves of the company, nor does it include the amount of interest which may be included in the payment of a policy obligation through application of the reserve to such payment—the very purpose for which the reserve is accumulated. Every death claim is paid at least in part out of the reserve upon the policy. Every payment of the cash surrender value of a policy is a payment of or out of the reserve. Each such payment to the extent that it constitutes a payment of or out of the reserve constitutes a payment of interest theretofore credited to the reserve. But it is the payment of a policy obligation and not the payment of an indebtedness of the company, and the interest so paid is therefore not deductible under Section 245 (a) (8) of the Act. This has been clearly held by the Board of Tax Appeals in *Reserve Loan Life Insurance Company* v. *Commissioner*, 18 B. T. A. 359, where it is said in the opinion at pages 368-9:

> "As pointed out in *Standard Life Insurance Co. of America, supra*, the payment of the face of a matured coupon, together with the interest thereon, constitutes the paying off by the company of a policy obligation and the surrender by the policyholder of

a part of his policy. This being true, the amounts paid or credited by the petitioner (company) during the respective years to holders of coupon policies do not, in our opinion, constitute interest paid or accrued on indebtedness within the meaning of Section 245 (a) (8) of the applicable Revenue Acts."

We do not in any sense abandon our contention that the funds held by respondent against matured unsurrendered coupons constitute "reserve funds" even within the restricted definition of that term contended for by the petitioner. It is submitted, however, that the entire argument upon which petitioner bases his case is beside the point and entirely immaterial because it is founded upon an assumption which finds no support in the Revenue Act and is squarely in conflict with the interpretation placed upon the act by the Treasury Department from the very beginning.

V.

There Is a Valid Distinction Between the Coupons Involved in This Case and Dividends upon Participating Policies.

Petitioner argues that there is no real distinction in principle, in so far as the reserve question is concerned, between a dividend upon a participating policy and a coupon of the type here involved. This argument is somewhat amazing in the light of the clear statement of the nature of dividends in the opinion by Mr. Chief Justice Hughes in *Williams* v. *Union Central Life Ins. Co.*, *supra*. It is there said on page 177,

> "'Dividends' are in a different category. In fixing the annual level premium, there is added to the

> sum required on the basis of the mortality table, and assumed rate of interest, an amount to cover anticipated expenses and contingencies. If the rate of mortality exactly coincided with the expected rate, and the income, expenses and contingencies were precisely in accordance with the allowance made therefor, there would be no surplus and hence no dividends. But in the actual course of business there may be, and probably will be, gains from the fact that the mortality turns out to be less than that expected, or that the income is larger or the outlays are less than those estimated, and these gains are distributable to policyholders by means of 'dividends' in accordance with the provisions of policies. The 'surrender value' is calculated on the basis of the reserve and without reference to such possible dividends."

The differences existing between dividends and coupons are obvious. Their sources are different. Dividends are not "something reserved from premiums to meet policy obligations at maturity." See, *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109, 119. Dividends are *earned* by the company through mortality savings, excess interest earnings and careful, economical management. Coupons, on the other hand, are "something reserved from premiums." Otherwise the company could not definitely obligate itself upon the coupons at the time of issue of the policies. Dividends are not fixed and definite policy obligations. The participating company makes no agreement to pay definite amounts of dividends when the policy is issued. Dividends grow out of the corporation-stockholder relationship rather than out of the insurer-insured relationship. Participating policies upon which dividends *may* be paid, if earned, do not, and cannot, obligate the company at the date of issue of the

policy for any specified amount of life insurance in addition to the original face amount of the policy. On the other hand the nonparticipating coupon policy obligates the company with respect to additional insurance from the moment the policy is issued. The company must keep itself in position to meet those definite policy obligations, and the funds with which it keeps itself in such position are "reserved from premiums" and are not contingent upon the company's earnings. The holder of a coupon policy is in precisely the same position as if he had received a policy containing two schedules of premiums and providing that if the larger amount of premiums be paid there shall be so much insurance in force but if the smaller amount of premiums be paid there shall be so much less insurance in force or the premium-paying period for the same amount of insurance will be larger. The holder of such a policy who pays the larger amount of premiums is in comparable position to the holder of a coupon policy who leaves his coupons with the company to accumulate at interest.

VI.

The Authorities Sustain Respondent's Contention.

Aside from the decision of the court of claims in *Continental Assurance Co.* v. *United States,* 8 Fed. Supp. 474, all of the income tax cases involving the precise point here at issue have been decided adversely to petitioner's contention. The first such case was *Standard Life Insurance Co.* v. *Commissioner of Internal Revenue,* 13 B. T. A. 13, later affirmed by the Circuit Court of Appeals, Third Circuit, in *Commissioner of*

Internal Revenue v. *Standard Life Insurance Co.*, 47 F. (2d) 218. Since that time the point has been before the Board of Tax Appeals many times and its decisions have been consistently adverse to the government. The Circuit Courts of Appeals for the Ninth Circuit and Tenth Circuit have reviewed decisions of the Board of Tax Appeals in such cases and have sustained the decisions of the board. *Commissioner of Internal Revenue* v. *Western Union Life Insurance Company*, 61 F. (2d) 207; *Commissioner of Internal Revenue* v. *Great American Life Insurance Company*, 70 F. (2d) 133; and the opinion of the court of appeals in the case at bar, 71 F. (2d) 962.

In view of this state of the authorities, the petitioner relies upon the decisions of this court in *McCoach* v. *Insurance Co. of North America*, 244 U. S. 585; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342; *United States* v. *Boston Insurance Co.*, 269 U. S. 197; and *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109.

Three of the above cases involve fire, marine or casualty insurance companies. *New York Life Ins. Co.* v. *Edwards, supra*, is a life insurance company case. All of the four cases involve reserve funds variously designated as "unpaid loss reserve," "loss claims reserve" or "reserve against accrued and unpaid losses." All of the four cases arose under revenues acts prior to the Revenue Act of 1921. In considering the bearing of those cases upon the case at bar one must refer back to the provisions of the acts prior to the 1921 Act. Gross income under the prior acts included premium income as well as investment income; the reserve deduction was

the amount of net additions to reserve funds; and an additional deduction was allowed for all losses actually sustained within the year and not compensated by insurance or otherwise. Since the elimination of premium income from gross income, the loss deduction is no longer allowed for obvious reasons. In the fact that the acts, under which the four cases, *supra*, arose, permitted the companies to deduct from gross income the amount of all losses sustained during the year lies the real ground for the result in those cases. That is the ground upon which the *McCoach* case was decided as is clearly shown by the following quotation from the opinion of Mr. Justice Pitney in that case:

> "There is a specific provision for deducting 'all losses actually sustained within the year and not compensated by insurance or otherwise.' And this is a sufficient indication that losses in immediate contemplation, but not as yet actually sustained, were not intended to be treated as part of the reserve funds; that term rather having reference to the funds ordinarily held as against the contingent liability on outstanding policies."

The *Boston Insurance Co.* case and the *New York Life* case are bottomed upon the *McCoach* case and their actual holdings go no further than the *McCoach* case. The unpaid loss reserves under consideration in those cases do not comply with the test which we have heretofore laid down for the determination of "reserve funds." They are not funds which the company is required to improve with interest and they are not "something reserved from premiums."

In the earnestness of their desire to find in these decisions of this court some aid for their contention in the

coupon cases, counsel for the petitioner have read into the language of the court in *New York Life Ins. Co.* v. *Edwards, supra,* a limited definition of the term "policy obligations" which the court did not and could not have intended because no such matter was before it for decision. The court well knew when that case was decided that life insurance companies assume many policy obligations which are not mortality obligations. That fact was also well known to the Congress when it enacted the various revenue acts. If there had been any desire upon the part of the Congress to limit the reserve funds of life companies to those funds held against life risk, such a provision would have been easy and simple to state. If the court had desired in *New York Life* v. *Edwards* to lay down the rule that the reserves of a life company consist only of those reserves held against mortality obligations, it would have employed specific rather than general language. There is no reasonable basis for imputing to the Congress or to the court an intention to use a general term in a restricted sense. That consideration becomes academic, however, so far as the coupons involved in the case at bar are concerned. The coupons are within the scope of the restricted terms which the petitioner would have us believe were intended by the Congress and by this court.

VII.

The Sole Decision Adverse to Respondent's Contention Is Based upon a False Assumption.

The court of claims in *Continental Assurance Co.* v. *United States,* 8 Fed. Supp. 474, approached the case

under a misconception of the fundamental theory and purpose of the reserve deduction provided by Section 245 (a) (2) of the Revenue Act of 1921. The court overlooked the fact that such deduction was granted for the purpose of eliminating from the taxable income of the company that portion of its investment income which it was required by virtue of its policy contracts to add to reserves for the protection of policyholders. For reasons heretofore stated in this brief we respectfully submit that the court of claims fell into error in the following respects: (1) it adopted a test for reserve funds for which there is no basis in the Revenue Act; (2) it misconceived the actuarial and legal effect of the coupon policy form involved in that case, and, therefore, erroneously concluded that the coupon reserve did not meet the requirements of the false test which it adopted; (3) it erroneously concluded that the funds held by the company against its liability upon matured coupons were not "reserve funds required by law" because they were not reported on line 7 or above of the liability page of the company's annual statement. Further comment upon the *Continental Assurance Co. Case, supra,* would involve needless repetition of the arguments heretofore presented herein. We believe that the decisions of the courts of appeals which have passed on this question have reached the correct result and should be sustained.

Conclusion.

In conclusion we respectfully submit that although the amount of tax involved in the case at bar is small, the

question at issue is important to a great many life insurance companies and involves in the aggregate a large sum of money. For these reasons we have desired to present to the court our views upon the various questions involved in this controversy, and we respectfully submit that the conclusion reached by the circuit court of appeals in this case is correct and should be affirmed.

Respectfully submitted,

THOMAS WATTERS, JR.,
EDWIN R. MORRISON.

SUPREME COURT OF THE UNITED STATES.

No. 537.—October Term, 1934.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Inter-Mountain Life Insurance Company. | On Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

[April 1, 1935.]

Mr. Justice Butler delivered the opinion of the Court.

The question for decision is whether assets held by the company in 1922 against matured and unpaid coupons attached to 20-payment life coupon nonparticipating policies constituted a reserve fund required by law within the meaning of § 245 (a) (2) of the Revenue Act of 1921.[1]

That section declares that net income means gross income less, among other permissible deductions, an amount equal to four per cent. of the mean of the "reserve funds required by law" held at the beginning and end of the taxable year. Respondent, a stock company, incorporated under Utah law and commenced business in 1911. The laws of that State require, as a condition of doing life insurance business, that the assets of the company shall equal or exceed all liabilities for losses reported, expenses, taxes and other outstanding liabilities including the legal reserves. And they prescribe the rate of interest to be assumed and the mortality table to be used for the purpose of making valuations of life insurance policies and determining the reserves required to be maintained.[2]

[1] "Sec. 245. (a) That in the case of a life insurance company the term 'net income' means the gross income less— . . . (2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year . . ." 42 Stat. 261.

[2] Revised Statutes of Utah, 1933, Title 43, c. 3, § 4. "No stock company shall do any insurance business in this state before its capital is fully paid up. Said capital must be unimpaired, that is, the assets of such com-

The record contains a specimen policy for $10,000 applicable to age 35 issued in consideration of 20 annual premiums of $420.90. Attached are 19 coupons maturing serially on anniversary dates of the policy beginning with the first and ending with the nineteenth. Each coupon is a promise that at its maturity the company will pay the amount specified to the owner of the policy.

The policy states: The company will credit insured the face amount of any matured coupon as it becomes due and pay compound interest thereon, thereby creating a fund to the credit of the insured which may be applied to the payment of premiums or at any time withdrawn in cash; and, if not so applied or withdrawn prior to his death, it will pay the coupon values with interest to date of death to the beneficiary in addition to the face amount of the policy. The insured during the first year or within a month after the due date of the second annual premium may elect to convert the coupons as they mature into paid-up life additions to the policy which are only reconvertible into cash surrender value.

At the end of 20 years if all premiums have been paid in cash and if the amount of each matured coupon has been left with the company to accumulate at interest, then upon surrender of the policy and all coupons the insured shall select one of the following options: A guaranteed cash payment of $8,000; a paid-up policy for $14,130, subject to insurability; a guaranteed annual income of $490 for at least 20 years and as many more as the insured shall survive; a paid-up policy for $10,000 and an annual income of $174.40 during life. At the end of 15 years the company will issue a fully paid-up policy of $10,000 upon surrender of the original policy and the first 14 coupons representing values left on deposit at compound interest.

The mean of the company's reserve funds in 1922 set up against liabilities other than matured coupons was $942,751.40. Later

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pany must equal or exceed all liabilities for losses reported, expenses, taxes and other outstanding liabilities, including the legal reserves as provided in sections 43-3-12 . . .'' § 12. ''For the purpose of making valuations of life insurance policies and of determining the reserves required to be maintained therefor under the provisions of this title the rate of interest assumed shall be 3½ percent per annum, and the rate of mortality shall be established by the table known as the 'American Experience Table of Mortality' for policies issued after January 1, 1910 . . .''

herein these are referred to collectively as "insurance reserves". The company claimed and the commissioner allowed as a deduction four per cent. of that amount. It carried a separate reserve against matured, unsurrendered and unpaid coupons, the mean of which in that year was $136,523.39. In its return the company deducted four per cent. of that amount but the commissioner disallowed the item. The Board of Tax Appeals, in harmony with its prior constructions of the clause in question,[3] held the coupon reserve deductible. It was sustained by the court, following cases in that and other Circuit Courts of Appeals.[4] 71 F. (2d) 962. That being in conflict with a recent decision of the Court of Claims,[5] this court granted a writ of certiorari. 293 U. S. —.

In the reserves required by the laws of Utah and of the other States in which the company issues policies of the described class, there is included an amount sufficient to cover not only all elements of insurance but also the coupon liability. We are not here dealing with reserves in relation to solvency of the company. The thing to be ascertained is the meaning that Congress intended by the language "4 per centum of the mean of the reserve funds required by law". The clause to be construed relates exclusively to life insurance companies. It is intended to define a deduction which they are permitted to make in the calculation of the net amount to be taxed. The rule that ambiguities in statutes imposing taxes are to be resolved in favor of taxpayers does not apply. Deductions are allowed only when plainly authorized. *Ilfeld Co.* v. *Hernandez*, 292 U. S. 62, 66. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440.

The word "reserve" has many meanings. Accounts creating reserves are set up in almost every line of business and funds

[3] Standard Life Insurance Co. of America, 13 B. T. A. 13. Reserve Loan Life Insurance Co., 18 B. T. A. 359. Farmers Life Insurance Co., 27 B. T. A. 423. Missouri State Life Insurance Co., 29 B. T. A. 401. Atlas Life Insurance Co., 29 B. T. A. 750.

[4] Commissioner v. Standard Life Ins. Co. of America (C. C. A.-3) 47 F. (2d) 218. Commissioner v. Western Union Life Ins. Co. (C. C. A.-9) 61 F. (2d) 207. Commissioner v. Great American Life Ins. Co. (C. C. A.-10) 70 F. (2d) 133.

[5] Continental Assur. Co. v. United States, 8 F. Supp. 474. Cf. Minnesota Mutual Life Ins. Co. v. United States, 66 C. Cls. 481. Massachusetts Mutual Life Ins. Co. v. United States, 56 F. (2d) 897.

evidenced by the book entries are held for many and widely different purposes. As the Act does not permit corporations other than insurance companies to make deductions of the kind here under consideration, "reserve funds" may not reasonably be deemed to include values that do not directly pertain to insurance. In life insurance the reserve means the amount, accumulated by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts. The premiums include enough, over and above what is needed to maintain proper insurance reserves, to provide for the discharge of coupon liability according to the terms of the policy. The coupon values are the equivalent of cash and may be used to pay premiums on the face amount of the policy, to procure additional insurance, to lessen the number of annual premiums or otherwise to obtain insurance protection. The amounts so applied cease to exist as coupon liabilities and automatically become a part of the life insurance reserves. These differ essentially from coupon liability. Life insurance matures only upon the death of the insured and the life reserve is based upon that contingency, whereas liability on the matured coupons depends upon no contingency. It follows that the insurance reserves alone constitute the base on which the deduction is to be computed. Reserves against matured coupons are excluded. *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585, 589. *United States* v. *Boston Insurance Co.*, 269 U. S. 197, 202. *New York Ins. Co.* v. *Edwards*, 271 U. S. 109, 119. *Duffy* v. *Mutual Benefit Co.*, 272 U. S. 613, 618-619. *Continental Assur. Co.* v. *United States*, 8 F. Supp. 474.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.